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TRADE, PAYMENTS LIBERALIZATION AND ECONOMIC PERFORMANCE IN GHANA

C. D. JEBUNI
A. D. ODURO
and
K. A. TUTU

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C.D. Jebuni,
A.D. Oduro, and
K.A. Tutu

University of Legon, Ghana

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Contents

List of tables

List of figures

I Introduction

All over Africa, countries are adopting structural adjustment policies with the hope of arresting two decades of economic deterioration. This deterioration has been attributed, among other things, to inappropriate trade and payments policies, such as overvalued exchange rates and exchange controls, high tariffs and quantitative restrictions which result in a divergence between world prices and domestic prices leading to policy-induced distortions with considerable macroeconomic implications (World Bank, 1990a). Central to these structural adjustment programmes has been the liberalization of trade and payments.

At the theoretical level, it is argued that the imposition of controls on international trade and payments may result in both micro- and macro-level distortions leading to adverse effects on resource allocation and economic performance. Liberalization of the trade and payments regimes removes these distortions and creates an enabling environment conductive to better economic performance. This may occur in the case of a devaluation through the effect on the relative prices of traded and non-traded goods and the relaxation of quantitative controls (World Bank, 1990a).

Trade and payments liberalization will have implications for employment, economic growth, balance of payments, government budgets and inflation. Of relevance also is the question of the sequencing and sustainability of the liberalization process.

The context within which liberalization takes place is essential to the sequencing and sometimes to the effects. Where liberalization takes place from a controlled regime facing shortages, import liberalization may be essential to support exports (Bevan *et al.*, 1987).

In general, studies on trade and payments liberalization show favourable effects on employment, economic growth and the balance of payments. A World Bank study of 19 countries found that there were small short-run unemployment effects for some countries, but in general, unemployment was seen to be insignificant in countries pursuing fast and strong liberalization (Papageorgiou, 1990). But this study did not include any African economies.

Experience varies across the continent depending upon the initial conditions before liberalization, structure of the economy, sequencing of the liberalization programme and level of external support. The current research is an attempt to document one such experience.

This study examines the experience of the trade and payments liberalization process in Ghana. In particular, it focuses on its effect on the balance of payments, government fiscal position and inflation.

II Evolution of the trade and payments regime in Ghana

Harry Johnson, writing on the relevance of the Asian and Latin American experience, concluded that:

> A developing country on a fixed exchange rate which undertakes a development programme and for this purpose employs the accepted techniques and instruments of planning will inevitably develop a balance of payments problem. If it adheres tenaciously to its exchange rate it will equally inevitably find itself forced to use its fiscal and other control instruments to compensate for the inappropriateness of its exchange rate (Johnson, 1970, p. 83).

The evolution of the controlled regime in Ghana seems to have followed this pattern. The regime has been determined primarily by balance of payments, fiscal control and industrialization through import substitution considerations.

It is possible to identify two cycles in the evolution of Ghana's trade regimes since the 1950s. Each cycle consists of five phases of the trade regime identified by Krueger (1978) and Bhagwati (1978). The first cycle is 1950-71 and the second cycle from 1972 to the present day. In the first cycle, Ghana's trade regime went through all five phases.

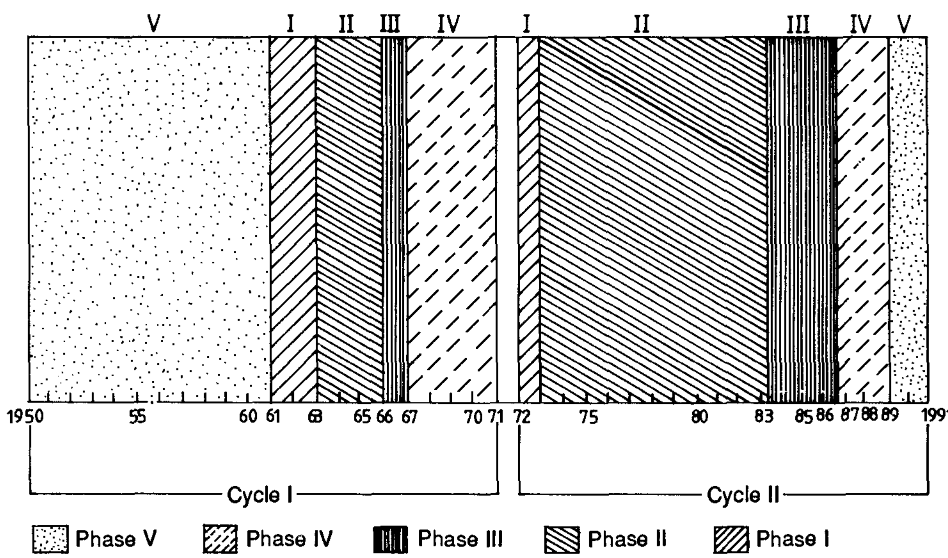
Cycle I:	1950-61	Phase V, Liberal trade regime
	1961-63	Phase I, Introduction of controlled regime
	1963-66	Phase II, Breakdown of control system
	1966-67	Phase III, Attempted liberalization
	1967-71	Phase IV, Import liberalization

In the second cycle, the first four phases of the trade regimes were experienced.

Cycle II:	1972	Phase I
	1973-83	Phase II
	1983-86	Phase III
	1986-89	Phase IV

Since 1989 it appears that Phase V may have begun.

Figure 1 Evolution of Ghana's trade regime, 1950-91



Trade and payments regime 1950-71

Details of the content of the trade and payments policies for the first cycle 1950-71 have been documented by Leith (1974). This section therefore provides a summary of the evolution of the period's trade and payments regime.

The period 1950 to 1961 was a period of fairly liberal trade and payments regime. As a member of the sterling area, Ghana, in the immediate post-independence period, was subject to the general prescription of currency requirements of the area as a whole. Payments to and from other countries of the area were relatively free while payments to third-party countries were subject to sterling restrictions. Within this framework Ghana experienced a fairly liberal regime.

As a result of improved export prices, reserves were built up during part of this period, followed by a gradual drawing down of these reserves. World cocoa prices increased from US$705 per tonne in 1950 to US$1274 in 1954. There was a slight decline in 1955 and 1956, and they rose again between 1957 and 1958. Thereafter, cocoa prices declined to their lowest level of US$379 in 1965 (World Bank, 1983). The years 1957-59 can be regarded as a period of consolidation in which projects started under the five-year colonial development plan were completed, while the process of developing the first post-independence plan was initiated.

The first five-year post-independence development plan in 1959 entailed massive increases in government expenditure, with a high import content. Real private consumption also increased from £295 million sterling in 1958 to £376 million in 1961 as a result of increased income. This, coupled with falling cocoa prices and a liberal trade regime, caused the foreign account deficit to increase sharply from US$19.4 million in 1959 to US$94.9 million in 1960, and US$135.1 million in 1961. With foreign exchange reserves declining sharply and the budget deficit rising rapidly, the government resorted to a series of strong measures. An austerity budget was introduced, and taxes raised. In July 1961, Ghana's rapidly dwindling foreign exchange reserves forced the government to pass the Exchange Control Act (Act 71) as part of a policy package to control and conserve foreign exchange. The act made drastic changes in the existing foreign exchange market (Huq, 1989). Foreign exchange controls were extended, and comprehensive import licensing was introduced by December 1961 (Stryker, 1990). In effect, the imposition of the controlled regime in 1961 was in response to balance of payments difficulties.

In spite of the deteriorating balance of payments and fiscal deficit situation, the government launched the seven-year development plan in 1963-64. This, as with the second five-year development plan, involved massive government expenditures to boost the import substitution industrialization effort. With the government refusing to accept an IMF/World Bank stabilization package involving a devaluation, it had to resort to ever-increasing trade restrictions to control the balance of payments and provide protection for domestic industry. This culminated in increasing pressure on the system resulting in rampant abuse and corruption. With seriously depleted foreign exchange reserves, the government resorted to increased borrowing abroad.

Between 1966 and 1967, Ghana entered Phase III of the controlled regime. The new government accepted the IMF/World Bank stabilization package and set about trying to stabilize the economy and getting inflation under control by using both deflationary fiscal and monetary policies and decontrolling state production. The system for allocating import licenses was altered to ensure efficient mobilization of domestic resources and adequate supplies of essential commodities for consumers (Leith, 1974). In order to avoid wasteful competition and under-utilized capacity, preference was given to larger, established firms with proven trade and financial contacts.

Nevertheless, although the corruption of the last years of the Nkrumah period was avoided, there was still a substantial amount of arbitrariness and inefficiency in the allocation procedure. Although the results of this effort were encouraging in terms of reduction in the current account deficit, urban unrest increased because of growing unemployment, reduced real incomes and declining expenditures on education and health services (Stryker, 1990, p. 52).

The balance of payments (BOP) situation remained precarious. There was considerable dissatisfaction with the rigid controls and macroeconomic austerity. There was also concern over the effect that rising expectations of possible changes in the exchange rate was having on potential foreign investment and a realization that donor assistance was unlikely until Ghana corrected its balance of payments. Rescheduling medium-term debt provided some immediate relief but not a long-term solution.

July 1967 saw the beginning of a liberalized import regime which was maintained until 1971. In July 1967, the currency was devalued by 43%, import duties were lowered on some selected essential commodities and the government committed itself to liberalizing imports over the next four years. However, in view of increasing urban unrest the restrictive macroeconomic policies could not be maintained. The liberalization therefore occurred with expansionary fiscal and monetary policies.

Liberalization policies were continued by the civilian government which took over in 1969. As they occurred in the absence of restrictive macroeconomic policies, pressure was put on the trade balance, but this was masked by high world cocoa prices, foreign aid inflows and some debt relief. Cocoa prices rose from US$379 per tonne in 1965 to US$1,108 in 1969. The government took advantage of high world market prices for cocoa in 1970 to permit a rapid expansion of expenditures and imports through the Open General Licence (OGL). This increased the balance of payments deficit. With accelerating inflation eating away at the devaluation of 1967, the real effective exchange rate on imports appreciated at the same time that the imports regime was being liberalized. With a substantial government deficit budgeted for 1971-72, upward pressure in prices seemed likely to erode import taxes and export subsidies. With a sharp drop in cocoa prices from US$997 in 1969 to US$565 in 1971, the trade account went into deficit. Foreign exchange reserves at the end of the third quarter of 1971 were less than half the trade deficit over the first three-quarters of that year. On 27 December 1971 the currency was devalued.

The government urgently needed foreign inflows to ease the foreign exchange constraint. However, any support from the international community was conditional upon restrictive macroeconomic policies including a devaluation. In addition to the 44% devaluation, government expenditures were cut, and some taxes were increased. Prices of most consumer items increased substantially, and these prompted a military coup on 13 January 1972.

The government made some attempts at liberalizing the trade regime between 1978 and 1980, but these were not sufficient to reverse the decline in these variables. The attitude towards the use of the exchange rate was ambivalent and objectives were not fulfilled. These was hesitancy in completely removing the controls because of the implications this would have on balance of payments. The import control system was therefore interfered with. Certain enterprises faced a comparatively liberal regime whilst others did not. However, since the government was not able to reduce the anti-export bias primarily due to its failure to devalue the nominal exchange rate significantly, these attempts at liberalization were unlikely to be successful.

Trade and payments regime, 1972-89

Details of the content of trade and payments policies for the first cycle, 1950-71, have been documented by Leith (1974). This section, therefore, provides an analysis of the policies for the second cycle.

The year 1972 ushered in the beginning of a period of strict import control which was in contrast to the liberalization process begun in 1967. In the following ten-year period a plethora of instruments were introduced to achieve the government's objectives. There was also a half-hearted attempt at liberalization in 1977 and 1978. In addition, there were rapid and frequent changes in the instruments employed.

Exchange rate policy

Politically the new government found it wise to reduce the rate of devaluation to 26% by revaluing the currency. It also unilaterally repudiated some of the debts and rescheduled the rest. In the same year, the government imposed stiffer import and payments controls because the international community was not prepared to grant any credit. Ghana had to meet its international obligations from its own resources. This led to the beginning of Cycle II, Phase I. It is interesting to consider why direct controls rather than exchange rates were used to stem the demand for imports. Direct controls were used primarily to restructure imports to conform to the policy of import substitution. The overall principle of government was self-reliance and a reduction in dependence on external resources. Thus, the initial use of direct controls may be explained within the context of government wishing to reduce imports significantly. It could also be explained by the need to nurture interest groups, e.g., the military. Quotas give a clear idea of what is coming in initially. However, the use of quotas within the context of price controls introduces distortions to the economy. As this happens, an increasing amount of economic activity gets diverted from channels directly under the control of government to other channels. The initial objective of control of the economy in order to move it in a particular direction is therefore lost since the official indicators give an inaccurate picture of the value of output produced and goods entering and leaving the economy. As this happens, the tax base of government declines, and if expenditures are not able to fall in line, they can put increasing pressure on the budget deficit. This may explain what happened in the Ghanaian case. The slow-down in the growth rate of export values put a constraint on the capacity to import which affected import volumes and the import tax base.

A fixed exchange rate policy was pursued during the entire period, despite the stated policy shift towards a flexible exchange rate in 1978 when the currency was devalued. The nominal exchange rate was revalued in February 1972 following the December 1971 devaluation. The revaluation of the cedi did not fully reverse the depreciation of the real effective exchange rate of the December 1971 devaluation (Table 1). The maintenance of strict import licensing after 1972 can then be understood since it was only in this way that the balance could be prevented from deteriorating further. The change in the nominal cedi-dollar rate in 1973 was due to the devaluation of the US dollar to which the cedi was fixed.

In the five-year plan for the period 1975/76 to 1979/80, the use of the exchange rate as a policy instrument was dismissed because policy-makers did not consider the conditions in the Ghanaian economy suitable for a successful devaluation (Republic of Ghana, 1977, p. 40). Preference was instead towards the use of variable purchase taxes, selective import duties and *ad valorem* licence levies to achieve the required changes in the exchange rate for imports. It was also stated within the same document that the currency was to be pegged to a basket of currencies. However, the cedi was not pegged to a basket of currencies, but devalued in 1978. At the time of the devaluation it was mentioned that a flexible exchange rate policy would be pursued. However, the policy of flexible exchange rates was only implemented for three months. Having dismissed frequent devaluations as a policy instrument, the government had to resort to fiscal and quantitative controls to influence trade flows.

All through the period of controls, the wedge between the parallel and official exchange rate widened. The parallel market premium increased considerably, particularly in the latter half of the period (Table 1).

Table 1 Nominal and real exchange rates

Year	Nominal (cedis/US$)	Real 1980=100	Ratio of parallel to official rate
1970	1.02	27.73	1.60
1971*	1.818	28.03	0.96
1972*	1.28	21.84	1.28
1973	1.149	25.43	1.29
1974	1.149	27.07	1.50
1975	1.149	30.37	1.73
1976	1.149	46.20	2.53
1977	1.149	89.57	8.00
1978*	2.75	101.73	5.93
1979	2.75	75.44	5.67
1980	2.75	100.00	5.77
1981	2.75	221.48	9.54
1982	2.75	277.67	22.42

*The year in which the official exchange rate was changed. In both 1971 and 1978 the devaluation occurred in the last quarter of the year. A decrease indicates depreciation.
Source: IMF, *International Financial Statistics Yearbook*. Black market rates obtained from Stryker, 1990, p. 279.

Quantitative restrictions and exchange controls

Quantitative restrictions were implemented through the issue of import licences which were not auctioned or resaleable. There were three types of licences: the Open General Licence (OGL) allowed registered importers to import freely the item specified on the licence; the Specific Licence required prior authorization before the goods were brought in; the Special Un-numbered Licence (later renamed the Special Licence), allowed imports to be brought in by importers who had access to their own foreign exchange.

As a result of the liberalization of the import trade regime, by 1970 almost half of the import items could be brought in using the OGL. However, by February 1972, most of the items were transferred to the Specific Licence lists and about 150 items were either restricted or banned. This list increased to 170 in 1973, and by the end of 1974 the OGL could only be used to import trade samples, gifts and personal effects. Items on the restricted list were not normally imported. The basic items on this list, for example rice and sugar, could only be imported by the Logistics Committee. Imports of government organizations were to be made through the Ghana Supply Commission.

The banning of items was a common practice during most of the period. Apart from balance of payments considerations, banning was implemented primarily as a protective measure. In some instances the banning order was issued without prior investigation into the possible effects of such a measure. For example, in August 1975 the importation of all textiles and textile goods was prohibited. In October of the same year a notice to importers was released stating that importation of textiles was to be limited only to industrial raw materials used by local industries registered with the Ministry of Industries.

Import programming was prominent during this period. In most cases the planned import levels were less than desired. The import programme which was introduced in 1972 provided for C235 million in imports for that year. This implied reductions for some categories of about 50% of their 1970 import levels. In 1975, the Import Advisory Committee of the Ministry of Trade and Tourism projected a minimum import requirement of C900 million. At the same time the operational programme which had been drawn up on the basis of available foreign exchange provided for C535 million. The non-priority areas were allocated between 45% and 75% of their projected requirements.

Import licences were to be allocated on the basis of the programme which had been drawn up. However, Table 2 shows that in most cases the value of import licences which were issued were always greater than planned import values, and the value of actual imports exceeded those planned.[1]

Table 2 Import licences issued and letters of credit established

	1976	1977	1978	1979	1980	1981
Initial programme for licences	554.0	1126.0	1600.0	2432.0	1702.1	1810.0
Actual import licences issued	978.4	1969.9	2349.7	3392.1	1938.9	2531.0
Letters of credit established*	865.4	1083.0	1183.0	1478.0	1058.2	
Approval of goods on collection basis	52.0	166.0	542.0	332.4	683.2	
Sum of items (3) and (4)* at 31 Dec.	917.4	1249.1	1725.0	1810.4	1751.4	

* excluding cancellations
Source: Central Bureau of Statistics, 1981; *Economic Survey 1977-80*, December, Accra; *Economic Survey 1981*, August 1983.

The failure of the import licensing system to issue licences within limits prescribed by the programme created a great deal of uncertainty. For example, the value of import licences was reduced in 1973; the face value of import licences for which no letter of credit was established was reduced by half in 1974, and in 1975 import licences were revoked. The difficulty in obtaining spare parts by the manufacturing sector in 1975 reduced the ability to maintain production levels. As a result of this the import licensing system was relaxed in 1976. This may explain the substantial overshooting of the import programme in that year.

The special unnumbered licences had a chequered history. They were abolished in 1974, re-introduced in 1975, and their use restricted in 1977. They were completely withdrawn in 1978 but re-introduced in 1980 as the Special Licence. Their use was restricted to the importation of food items, soaps, detergents, agricultural implements, raw materials for approved industries, educational materials, motor spare parts, newsprint and printing machines, hospital equipment and pharmaceuticals. The disadvantage of the frequent changes in the use of this category of licence is that it made planning hazardous for economic agents who may have been using these licences to import their required inputs. The removal of these licences served to tighten import controls. It reduced the availability of foreign exchange for the finance of imports. It also implied that prospective importers were forced to go through time-consuming bureaucratic procedures which were being used to screen imports.

In the 1973-74 budget, government recognized that the reduction in import values in 1972 had been due mainly to the import controls which had been introduced in that year. It was not, however, the intention to depend on import controls to achieve balance of payments objectives. It was to be done through the encouragement of exports, particularly non-traditional exports. The role of direct controls was to restructure imports to conform to economic policy, i.e. to achieve among other things the protection of domestic industry. In the five-year plan for the period 1975/76 to 1979/80, this role of direct controls was reiterated. Despite these assertions direct controls were resorted to increasingly for balance of payments purposes because of the failure of government to pursue appropriate macroeconomic and exchange rate policies to tackle the balance of payments problem.

By 1977 it was recognized that the strict import control system contributed to the economic problems facing the manufacturing sector. It was therefore decided that restrictions on the importation of raw materials and spare parts for some of the large enterprises within defined industries would be lifted. The industries identified to benefit from the liberalization scheme were food processing, poultry, beverages, soaps and detergents, textiles agricultural machinery and implements, pharmaceuticals, transportation and household goods. Enterprises which were to benefit from this scheme were mentioned specifically in the budget statement of 1977/78. Other named enterprises within these industries would be eligible for a lifting of the restrictions within limits agreed upon with the Ministry of Finance. It was anticipated that the increase in production resulting from the reduction of the import constraint would contribute to the reduction of inflationary tendencies in the domestic economy. It was recognized that the liberalization of the import trade regime could have adverse effects on the balance of trade. The affected industries were therefore required to increase exports in order to reduce the possibility of the worsening balance of trade (Ministry of Finance, 1977, pp. 17-19).

Exchange controls which had been in operation prior to 1972 were maintained and operated hand in hand with the import licensing system to control the use of foreign exchange. All invisible payments had to be approved by the Exchange Control Department of the Bank of Ghana. Export proceeds had to be collected and repatriated to Ghana within 60 days of shipment. The export proceeds in foreign exchange had to be deposited with the commercial banks.

Restrictions were put on the amount of foreign exchange which residents could take abroad. In 1973 the basic allocation of foreign exchange for tourist and business travel was suspended. It was not re-introduced until 1978 and then removed again in 1979. In 1973 residents travelling abroad were allowed to take out the equivalent of C236.5 in foreign exchange. The allowance was reduced to C100 in 1974 and remained at that level until 1979 when it was increased to C160. Non-residents were allowed to take out the equivalent of monies which they had brought in and which had not been spent.

Taxes on foreign trade

Several changes were experienced in the pricing instrument used to influence the quantity and structure of imports during this period. Table 3 provides information on the announced tax schedules for the various tax instruments used.

There was a restructuring of the tariff system in the 1972-73 budget to introduce a system which would encourage domestic manufacturing and enable a more effective control of the import trade. This was insufficient to solve the problem of inadequate revenue generation because the issue was re-addressed in the 1973/74 budget. The projected revenues in the previous year's budget had not been met, and this was attributed to the wide differences in the rate of duties (e.g., import duty rates ranged from 5% to 150% in 1972) within commodity groups. This made tax evasion through the misclassification of imports easy. The 1973/74 budget streamlined the tax schedule by merging the sales tax and import duties and by narrowing the tax range (Table 3). The import licence levy remained. This was in order to make up for the estimated revenue loss due to the decline in the tax rates of some commodities.

Separate targets were created for direct controls and the tariffs. The former was to be responsible for influencing the structure and quantity of imports, and the latter's main objective was to generate revenue. As a result of the narrowing of the tariff range the effective rate of duty collection improved slightly in 1973-74 to 23% compared with 21% in 1972-73 (Ministry of Finance, 1975, p. 4). The tax schedules were therefore maintained in the 1974-75 budget, the only significant change being the increase in the import licence levy on textile imports from 30% to 50%. This was mainly a protective measure to compensate textile manufacturers for the increase in the prices of raw materials, especially raw cotton. In the 1975/76 budget statement, the customs duty and import licence levy on selected items was adjusted upwards as a revenue-generating measure. It was estimated that the increase in rates would increase revenue from duties by C6.21 million, thus contributing to closing the anticipated budget deficit gap (Ministry of Finance, 1975, p. 23).

Table 3 Tax schedules 1972-82

	Import duties %	Sales tax %	Import licence levy %	Special tax %
1972	5-150	11.5	7.5 on finished goods	
1974	20-50	unified with the import duty	5,10,20,30	
1975	20-50		5-150	
1976	20-50		10	
1977	0 for agricultural inputs 35,60		abolished	
1979	0,35,60			
1980	0,35,60		10	
1981	35,60,100		20	20

Source: Budget statements for the respective years.

However, the problem of not being able to achieve import revenue objectives remained. In 1975, the effective duty collection rate had declined. Another restructuring of the import tariff schedules took place in the 1977-78 budget in order to rectify this. The import licence levy was abolished and the import duty schedule consisted of two rates, i.e. 35% for all tax categories which were previously below 60%, and 60% for all tax categories which were previously above 60%. It was hoped that this would reduce misclassification of commodities and that it would also reduce the ability of tax collecting agencies to impose discretionary rates. Apart from changes in the tax schedules, the budget also changed the import licensing procedures. Another reason for failure to achieve revenue objectives was the problem of *ad hoc* exemptions, whereby importers who were not liable to pay tax may have been able to transfer this benefit clandestinely to others.

Apart from the frequent change in tax structures on an annual basis, there also were frequent changes among commodity categories as the tax rates for certain commodities were upgraded during the course of the year or vice versa. Table 4 provides information on the average (unweighted) tax rates for imports. The data shows that this rate was consistently lower than the average suggested by the tax schedules. Between 1974 and 1980 this average rate remained lower than the average for the period 1972-73.

To obtain an idea of the effect of the tax structure of the system of incentives, the bias in the trade regime was calculated. It may be measured as the ratio of the effective exchange rate of exports to the effective exchange rate of imports. The effective exchange rate of exports ($EERx$) is the amount of domestic currency the exporters receive as a result of earning a unit of foreign exchange. It takes into account any taxes and/or subsidies which exporters pay or receive. The effective exchange rate for imports ($EERm$) is the amount of domestic currency that has to be paid in order to obtain imports worth one unit of foreign exchange. Therefore,

$$EERx = Ex\ (1 + s - tx)$$

and

$$EERm = Ex\ (1 + tm + q + P)$$

where

Ex is the nominal official exchange rate for exporters
Em is the nominal official exchange rate for importers
s is any trade subsidy going to the export sector
tx is export tax

q is the import surcharge
P is the premium due to the quantitative restrictions (i.e. import quotas)

A value less than one implies there is a bias against export activities. A value greater than or equal to one implies a bias in favour of export activities. An important omission in the calculation of the bias in the trade regime from the information provided in Tables 4 and 5 was the import premium. The premium may be measured as the ratio of the difference between the domestic price and the border price (inclusive of tariff) to the border price (inclusive of tariff). However, the information on domestic prices presented in the wholesale price index will not give an accurate measure of the premium since they are not market prices. Prices during this period were subject to price controls so that officially recorded prices may underestimate the size of the premium. Another measure would be the black market premium. This however is subject to some errors since the size of the premium may be influenced by criminal activities, for example, drug trafficking. The estimates of the bias in the trade regime in Table 6 therefore underestimate considerably the extent of the bias due to the omission of this variable. For the years for which adequate information on price measures facing traded goods is available the effect of these measures has been to create an anti-export bias.

Table 4 Price distortions facing total imports

Year	Tariffs*	Purchase tax	Sales tax	Total rate	*EERm*
1970	17.02	0.91	7.82	25.75	1.28
1971	18.57	1.39	7.41	27.37	1.31
1972	14.70	1.70			
1973	18.05	0.76			
1974	11.98	0.76	-	12.74	1.29
1975	10.21	1.29	-	11.50	1.28
1976	11.65	1.17	-	12.82	1.29
1977	12.61	N/A	-		
1978	18.29	N/A	-		
1979	16.98	0.44	-	17.42	3.22
1980	12.78	0.12	-	12.90	3.10
1981	18.20	0.61	-	18.81	3.26
1982	19.42	0.78	2.75	22.95	3.381

Note: *Includes surcharge and special development levy; N/A not available in calendar years. Between 1974 and 1981 the sales tax was consolidated in the import tax.
Source: Statistical Services, *Quarterly Digest of Statistics*, various issues, Accra.

Table 5 Price distortions facing taxed exports

Year	Cocoa		Non-cocoa		Total exports	
	Tax rate	EER	Tax rate	EER	Tax rate	EER
1970	52.28	0.49	0.40	0.624	42.71	0.624
1971	61.46	0.396	0.45	1.023	33.74	0.681
1972	40.99	0.718	0.35	1.314	21.16	1.039
1973	26.44	0.856	0.94	1.153	12.98	1.013
1974	38.02	0.712	2.27	1.123	20.94	0.909
1975	56.17	0.504	1.85	1.128	34.12	0.757
1980	32.74	1.849	0.08	2.748	20.20	2.19
1981	39.63	1.66	0.29	2.742	16.35	2.30
1982			0.19	2.745	0.103	2.747

Financing of trade

Refundable cash margin deposits were re-introduced in 1974 and remained until 1981 when they were abolished. These cash deposits were to be deposited in a special account with the Bank of Ghana before a letter of credit would be opened. The deposits were refunded when the bills were submitted for payment.

Table 6 Estimates of the bias in the trade regime

Year	Bias
1974	0.701
1975	0.590
1976	0.748
1979	0.285
1980	0.705
1981	0.704
1982	0.812

The structure of the cash deposits scheme favoured non-consumer goods as against consumer goods (Table 7). Particular items, for example, fertilizers and crude oil, did not require prior cash deposit.

Table 7 Cash deposit requirements (%)

	1974	1975	1977	1980
Industrial raw materials, spare parts	50	25	25	25
Machinery and equipment	75	50	50, 20 for timber industry	50, 20
Lubricants	75, 0 for crude oil	0, 50	0, 25, 50	0, 25, 50
Fertilizers	0	0	0	0
Others	100	65	65	65

Credit availability was also used as a measure to regulate imports. The import sector was defined as a non-priority area, and on occasion directives were sent out limiting the credit which was to be allocated to the import sector. For example, in 1975 it was stipulated that bank lending to finance imports was not to exceed a stated level.

There was a decline in the share of commercial bank credit going to finance the import trade during this period. From 1979, credit going to finance exports exceeded that going to finance imports by a significant margin.

In another attempt to restrict imports, the rate at which credit was lent out to finance imports was higher than that charged to exporters between 1978/79 and 1980/81, i.e. 18% as against 13%.

Table 8 Commercial bank loans and advances (end of period, C millions)

Year	Import trade		Export trade		Total loans
1972	32.4	(20.75)	19.2	(12.29)	156.1
1973	36.0	(12.69)	18.6	(6.55)	283.6
1974	53.1	(13.71)	16.0	(4.13)	387.1
1975	33.9	(8.61)	19.1	(4.85)	393.6
1976	31.7	(6.28)	21.0	(4.16)	504.1
1977	25.6	(3.69)	26.2	(3.77)	693.4
1978	46.1	(4.91)	23.8	(2.53)	938.4
1979	30.0	(2.97)	40.0	(3.96)	1009.0
1980	25.5	(1.68)	260.8	(17.18)	1517.2
1981	40.2	(2.01)	336.7	(16.83)	1999.6
1982	37.0	(1.64)	249.4	(11.75)	2251.8

Note: Figures in parentheses are percentage shares. Export trade figures exclude cocoa financing.
Source: Central Bureau of Statistics, *Quarterly Digest of Statistics*, December 1988 and June 1989.

Moves towards liberalization, 1983-86

By 1982 import volumes, real government revenue and cocoa export volumes were at their lowest levels since the 1960s. Most economic variables had negative growth rates and the economy was facing a severe foreign exchange crisis. Between 1972 and 1982 merchandise exports contributed on average 69% to total gross foreign exchange inflows. For part of the 1970s the contribution was as high as 85%. The decline in the growth of export values and the dependence on foreign exchange earnings from merchandise exports for a significant proportion of foreign exchange inflows in the 1970s meant that the capacity to import had declined over the period 1972-82. The domestic manufacturing sector is highly import-dependent with most sectors depending on imported raw materials for a significant proportion of total requirements. Shortages in required raw materials, spare parts and capital goods were identified as being important determinants of excess capacity in the manufacturing sector (MDPI, 1974). The problem was not limited to the manufacturing sector. The cocoa sector, for example, was adversely affected by the inadequate supplies of insecticides, pesticides and spraying cans (Nyanteng, 1980). The alleviation of the stranglehold which the import shortages had on the Ghanaian economy could only occur if there were an improvement in the performance of the export sector and an increase in external financial inflows. In order for there to be such an improvement, it was necessary that the incentive structure for exports in particular be improved. Theoretical analysis has shown that export sector activities are affected by policy towards imports (Clements and Sjaastad, 1984). Econometric evidence available shows that approximately 74-85% of import taxes in Ghana are shifted to the export sector (Jebuni *et al.* (1992). The estimates of the incidence parameter for Nigeria (Oyejide, 1986) and Zaire (Tshibaka, 1986) show similar magnitudes. A restrictive import trade regime with an anti-export bias will only serve to discourage export production. There was, therefore, a need to liberalize the trade regime and remove the anti-export bias.

The import liberalization process which began in 1983 was part of a broad macroeconomic programme, the objective of which was to reverse the decline in major economic indicators and to deal with the severe foreign exchange crisis which was facing the economy.

Exchange rate policy

The move towards import liberalization began in April 1983 with the sharp devaluation of the effective exchange rate. The exchange rate changes brought about significant changes in the real exchange rate. A devaluation can result in the liberalization of the trade regime if it absorbs the import premium of the import licences. The devaluation will also reduce the anti-export bias if the domestic price of importables does not increase. This will happen if the effect of the devaluation is to absorb the import premium, and if the devaluation is accompanied with inflows of external finance which allow an increase in import volumes (Krueger, 1978, pp. 93, 100). The liberalization process will be sustained the greater the depreciation of the real exchange rates as a result of the nominal devaluation.

In April 1983 a multiple exchange rate system was introduced. The nominal exchange rate remained fixed at its 1978 level, but a system of bonuses and surcharges was introduced which increased the actual exchange rate. As a result of the system of surcharges and bonuses, traditional exports and imports of crude oil, essential raw materials, basic foodstuffs and capital goods were subject to an actual rate of C23.75 to one US$. Non-traditional exports and other imports faced a rate of C25.975/US$.

Table 9 Nominal and real effective exchange rates 1983-86 (C/US$)

	Nominal (C/US$)	Real effective rate 1980=100	Ratio of parallel to official rate
April 1983	2.75		
October 1983	30.00	242.99	22.2
December 1984	50.00	72.27	3.2
December 1985	60.00	52.23	2.8
January 1986	90.00	30.54	1.8

Note: A decrease indicates depreciation. Real effective exchange rate obtained from IMF files.
Source: Ratio of parallel to official rate obtained from World Bank, 1989, *Ghana: Structural Adjustment for Growth*, Report No. 7515-GH.

The exchange rate was unified in October 1983 at C30 to one US$. Three nominal devaluations took place in 1984 and 1985 respectively (Table 9). The currency was devalued again in January 1986. A multiple exchange rate system based on an auction system (Window II) and a fixed exchange rate (Window I) was introduced in September 1986. The objective of the new system was to allow the exchange rate to be determined by domestic demand and supply factors, promote trade liberalization and divert foreign exchange held outside the banks into the banking system. The rate at the first window was the prevailing official rate which had been set in January of that year. The rate at the second window was determined by weekly foreign exchange auctions held by the Bank of Ghana.

In the first auction that was held the marginal pricing system was used. In subsequent auctions the Dutch pricing system has been used whereby individuals purchase the foreign exchange at their bid price. In order to participate in the auction system prospective users of foreign exchange need to obtain a foreign exchange bid application form from the commercial banks for a fee and then provide a pro-forma invoice and a tax clearance certificate.

The nominal devaluations made a significant depreciation of the real exchange rate, thus enhancing the possibility that the liberalization process would remain on course. The devaluations were also accompanied by a reduction in the gap between the official rate and the parallel market rate (Table 9). The frequent changes in the rate during the three-year period beginning from October 1983 would have contributed to generating confidence that the liberalization programme would be maintained.

Quantitative restrictions

Import programming was maintained until 1986. The import programme and foreign exchange budget were formulated within the broad policy objectives of the Economic Recovery Programme (ERP), one of which was to "increase the overall availability of foreign exchange in the country, improve its allocation mechanism and channel it into selected high priority activities" (Republic of Ghana, 1983, p. 16). The objective of the 1984 foreign exchange budget in particular was to allocate foreign exchange to activities which satisfied the following criteria:

- improve the infrastructure of the economy so as to contribute to an increase in production, distribution and imports;
- contribute to higher government revenues and reduce the budget deficit;
- increase the supply of consumer goods.

In order to improve the import programming procedures so that the situation of oversupply of import licences would not occur, an Import Programming and Monitoring Committee was set up. The members of the committee were to be the Secretaries of Finance and Economic Planning, Industries, Agriculture, Trade and Health. The co-ordinating secretary was the chairman of the committee. The committee's prime concerns were:

- drawing up the annual programme;
- examining and approving allocations made by the ministries to ensure effective use of maximum benefit from the licences issued;
- scheduling the submission of letters of credit applications and monitoring their establishment so that priority sectors would have first access to the available foreign exchange;
- undertaking periodic reviews of the import programme within the context of possible changes in domestic and external conditions.

The import programme drawn up for the years 1983-85 allocated the largest share of the funds to transport and energy (Table 10). This was in line with the objective of the ERP which was to improve the infrastructure and incentives (including non-price) so as to encourage production and improve distribution. The programmes were drawn up on the basis of projected foreign exchange availability. External donors and organizations have played a significant role in the moves towards liberalization. The bulk of the finance of the import programme was expected to come from external sources (Table 11).

Table 10 Import programme 1983-85 (US$)

Sector	1983 Amount	1983 %	1984 Amount	1984 %	1985 Amount	1985 %
Export	211	19.18			186	19.91
Cocoa			41.01	4.13	39	4.17
Mining			27.71	2.79	93	9.95
Forestry			43.23	4.35	49	5.24
Non-traditional					5	0.53
agriculture	67	6.09	41.0	4.13	84	8.99
Food	65	5.90	76.58	7.71	78	8.35
Health	50	4.54	16.63	1.67	9	0.96
Transport	350	31.81	110.85	11.16	85.7	9.17
Energy			297.71	29.99	280.0	29.97
Crude oil					211.0	22.59
Other					69.0	7.38
Education	20	1.81	11.08	1.16	9.0	0.96
Manufacturing	151	13.72	91.41	9.21	123.0	13.16
Construction	45	4.09	27.71	2.79	54.0	5.78
Work & housing					20	2.14
Roads & highways					34	3.64
Water & sewerage			11.08	1.16	18	1.92
Essential						
consumer goods			19.40	1.95		
Others	141	12.81			10	1.07
Total	110		815.4		934	

Source: *PNDC Budget Statements*, 1983, p. 21; 1984, p. 42; 1985, p. 27.

Table 11 Foreign exchange availability by source (US$)

Year	Foreign		Domestic	
	Amount	%	Amount	%
1984	553.1	64.92	298.8	35.07
1985	589.9	63.0	344.3	37
1986		76		24
1988	583.5	60.6	380.4	39.4

Source: *PNDC Budget Statements*, 1984.

The import licensing system which was in operation prior to 1983 was maintained until 1986 when the new exchange rate system was introduced. There was a redefinition of import licence categories, with three types in operation. The first was the "A" licence which allowed the holder to bid for foreign exchange at the Bank of Ghana auction. Items which could be imported using this category of licence were pharmaceutical goods, raw materials, spare parts and other producer goods. The second was the "S" licence which was similar to the previous Special Licence. Holders of this could not bid for foreign exchange at the Bank of Ghana auction, and licences were valid for six months. The third was the "G" licence which was issued to government organizations for the importation of essential goods and services. It was allocated to the ministries which submitted licences to the Ministry of Trade and Tourism. The "G" licence allowed government organizations to use foreign exchange without making recourse to the auction.

Taxes on foreign trade

The tax schedules were adjusted downwards in 1983 with the introduction of bonuses and surcharges. The net effect though was to increase the effective exchange rates of both imports and exports. The tax structure remained stable over the period 1983-85 (Table 12). The major significant change in the structure of taxes between 1983 and 1985 was the 50% tax on special licences. In 1986 there was a decline of between 5 and 10 percentage points in the tax rates for all import categories except luxury goods. A licence tax of 0.1% was levied on the "A" licence. Holders of the "S" licence were required to pay a 20% advance income tax; however, importers of agriculture-related items were exempt from paying this tax.

Table 12 Import tax schedules (%)

	1983	1984	1985	1986
Import duties				
Concessionary	10-20	10-20	20-25	10-20
Basic raw materials	25	25	25	10
Other raw materials	30	30	30	20
Capital goods	30	30	30	20
Consumer goods	30	30	30	25
Luxury items	30	30	30	30
Import sales tax				
Concessionary			10-15	10
Basic consumer goods			20	10
Luxury goods			70	20
Special development tax				
Special licences	10	20	50	50
Import licence fee				
Special licence*	20	20	20	20
"A" licence				0.1

Note: *advance income tax
Source: National Revenue Secretariat, Accra.

In 1986 an escalating tariff structure was established with raw materials and capital goods having a lower import tariff rate than consumer goods and luxury goods; the effect of this therefore being to increase the effective rate of protection of the domestic import substituting (consumer goods) industries compared to the previous period.

Krueger (1978) identifies conditions which are necessary to ensure a successful devaluation. These are favourable conditions in the world market for the major export commodity, a favourable crop harvest, favourable terms of trade and low inflationary tendencies. Other variables of relevance are the availability of inputs and domestic credits, the state of the marketing network and infrastructure. These are important in explaining the supply response to relative price changes brought about by the devaluation. These initial conditions did not exist at the time Ghana embarked on the liberalization of trade regime. Despite this the devaluation of the real exchange rate was maintained.

In an analysis of the conditions which contribute to a successful transition from exchange controls, based on evidence from ten country studies, Krueger states:

> The lesson would appear to be that transition ... can best be achieved by adopting a sliding peg at a realistic rate and simultaneously borrowing a quantity of foreign exchange sufficient to permit an immediate liberalization of imports (to the extent that the premium on import licences disappears) (1978, p. 241).

A recent study of trade liberalization programmes in 19 countries found that in all but one of the liberalization programmes which was sustained a depreciation of the real exchange rate formed a significant component of the package. It was also found that most programmes which were sustained began with a substantial devaluation of the currency. Thus, timing of the devaluation was important (Papageorgiou *et al.*, 1990).[2]

The description provided above of the steps taken to liberalize the trade regime in Ghana between 1983 and 1986 indicates that by the end of 1986 conditions existed which could sustain the liberalization process. However, some reservations may be expressed concerning the role played by foreign finance. This is because if the external flows are debt-creating, they leave the recipients with a future debt obligation. The success of a liberalization process in which foreign borrowing forms an integral component depends on whether the liberalization will bring along with it increases in real income growth rates and export earnings. The inflow of external finance may avoid a recession in the economy as liberalization occurs (Papageorgiou *et al.*, 1990, p. 240); however, it is not certain that future growth can be guaranteed.

Liberalization, 1986 to present

The liberalization process was pursued further in 1987 with the conclusion of the fixed exchange rate policy. This was brought about with the closure of the first window at the Bank of Ghana. Henceforth, all transactions had to take place at the Bank of Ghana auction. When the two-window system was in operation, foreign currency earnings from the export of cocoa and residual oil were transacted at the first window.

In March 1987, service and transfer payments approved by the exchange control authorities could purchase foreign exchange at the auction. In the same year approximately 70% of the goods which had previously not been on the "A" licence list were transferred to that list from the "S" licence, and so were eligible to purchase foreign exchange at the auction.

Several significant changes took place in 1988. The first was the introduction of the forex bureaux. The bureaux could sell foreign exchange freely to importers and other users of foreign exchange and could purchase foreign exchange from non-traditional exporters and recipients of remittances from abroad. The exchange rate was determined by the demand and supply of foreign exchange. With the introduction of the forex bureaux there were two "market determined" official exchange rates.

Table 13 Nominal and real effective exchange rates 1987-90 (period averages, C/US$)

Year	Nominal rate	REER
1987	162.37	25.2
1988	202.35	22.2
1989	270.00	19.9
1990	326.33	17.7

Source: Statistical Services, *Quarterly Digest of Statistics*, March 1991, Accra; World Bank.

The second change was the relaxation of the exchange control regulations. Residents could take out a maximum of US$3,000. Third, the liberalization of access to the Bank of Ghana foreign exchange auction was continued further when the remaining holders of the "S" licence who were previously excluded were eligible to bid for foreign exchange at the auction.

In January 1989, the import licensing system was removed. This was because "recent economic measures like the foreign exchange auction and the establishment of forex bureaux no longer justify the continued operation of the import licensing system" (Dr K. Botchwey in 1989 Budget Statement). With the end of the import licensing system, the exchange rate and international trade taxes became the major instruments used in the implementation of trade policy.

The tax schedules were adjusted upwards in 1987 but reduced in 1988, so that they were below the rates prevailing prior to 1986 (Table 14). The escalating tariff structure was maintained. The basis on which the sales tax was calculated was adjusted in the 1988 budget. It was formerly calculated as a percentage of the CIF value. The new method calculated the sales tax as a percentage of the CIF value plus the import duty value. Second, both domestic and imported items were made subject to the same sales tax rate.

Table 14 Import tariff schedules 1987-90

	1987	1988	1989	1990
Import duties				
Concessionary	10-25	10-25	10	10
Basic raw materials	15	10	10	10
Other raw materials	20	15	15	10
Capital goods	25	15	15	10
Consumer goods	35	20	20	20
Luxury items	30	25	25	25
Import sales tax				
Concessionary	10-20	10	10	10
Basic consumer goods	35	25	22.5	22.5
Luxury goods	45	35	35	35
Special development tax				
Special licences	50	50	0	0
Import licence fee				
Special licence	20	20	0	0
"A" licence	0.5	0.5	0	0

Source: Statistical Services.

With the removal of the import licensing system in 1989, the cost of importing was reduced for most items because of the elimination of the Special Development Tax and import licence fees. The tax rates on other raw materials and capital goods were reduced in 1990, thus contributing to increasing further the effective rate of protection of the consumer goods industry.

In order to protect selected industries, duty protection rates of 10-40% were to be imposed on the following items: textiles; alcoholic and non-alcoholic beverages; tobacco; rubber and plastic products; pharmaceuticals, especially anti-malarials and analgesics; toiletries and cosmetics; soaps and detergents; garments, especially children's clothes; and food preservation, processing and canning. At the same time, the special tax levied on local production of textiles, alcoholic and non-alcoholic drinks was made applicable to the imports of these items.

Estimates of the bias in the trade regime indicate that there has been some decline in the anti-export bias since 1983. This has been due to a decline in the export tax rate which has been greater than the decline in the import tariffs. Because of the difficulty in calculating the import premia during the period of controls, the extent of the reduction in the anti-export bias during the present liberalized trade regime compared with the period of controls has been underestimated.

Table 15 Estimates of the bias in the trade regime 1983-91

Year	Bias
1983	0.608
1984	0.680
1985	0.637
1986	0.718
1987	0.726
1988	0.775
1989	0.777
1990	0.779
1991	0.835

By 1990 Ghana's import trade regime had changed dramatically from what it had been in the 1960s when import controls were first introduced, and in 1972 when they were re-introduced. There was a floating exchange rate regime, the first since the post-independence period, import licensing was abolished, the import tariff schedules were reduced dramatically and restrictions on the outflow of foreign exchange were relaxed substantially.

One study showed that all trade liberalization programmes which had *not* been sustained had failed to relax quantitative restrictions. The authors concluded that "radical reform of the QRs seems to be all but a necessary condition for the success of trade reform" (Papageorgiou *et al.*, 1990, p. 17). Thus, Ghana's trade liberalization programme has the major ingredients necessary for success and sustainability. Though these may be necessary, they might not be sufficient conditions since a lot also depends on external influences, for example, terms of trade and growth in the major economies. Other important aspects include the Economic Recovery Programme, credit policy and the social impact of the entire programme.

The present liberalization phase differs from the previous one (1967-71) in four major respects:

1. Time period covered by the liberalization programme;
2. Continuous depreciation of the real exchange rate because of frequent nominal devaluations;
3. Ability to achieve a complete liberalization of imports with the complete removal of the import licensing system;
4. Accompanying fiscal and monetary policies which are more restrained in the present liberalization phase.

Although restrictive fiscal and monetary policies preceded the import liberalization in the previous liberalization episode, constraints on the growth of government expenditures were not maintained during the entire period. In the present period, the growth of government expenditures has been declining since 1985, thus a fairly cautious fiscal policy had been pursued during a greater part of the period.

III Trade and payments regime and balance of payments[3]

Trade liberalization

Theoretical discussions will lead one to believe that the effect of a trade liberalization programme on the balance of payments depends on the content of the liberalization programme, the relative responsiveness of exports and imports to any changes in the incentive structure, the accompanying macroeconomic policies, public perception of the liberalization programme and the initial economic condition (Bevan *et al.*, 1987; Rodrik, 1990; Papageorgiou *et al.*, 1990; Krueger, 1978).

There is no unambiguous definition of what is meant by trade liberalization (see Edwards, 1989, for a discussion of this). Most economists will accept as a minimum criterion the definition provided by Krueger (1986) which is that a liberalized regime constitutes a shift from the use of quantitative restrictions to the use of price instruments. In fact according to this definition a tariffication of the QRs would constitute a liberalization. This is a second best liberalization. A broader definition of trade liberalization requires the removal of QRs and a reduction in import tariff rates. This is a move towards free trade. A third conceptual distinction may be made in terms of moves towards neutrality. This represents an increase in export incentives with given inports protection.[4]

If it is possible to calculate and substitute the tariff equivalent of the import premium going to import licence-holders whilst keeping the value of imports constant, the resultant effect is that there will be no change in the domestic price of imports. Relative prices (i.e. the price of tradables relative to non-tradables) will not change so that the export sector is not expected to respond to the liberalization of the import trade regime. The effect of tariffication of the quota transfers revenue from the private sector to government. Thus income, i.e. the rent going to the quota-holders, will decline. If part of this rent were spent on imports, then private sector imports would decline. Whether or not the entire quota is utilized depends on the government's marginal propensity to import.

If, instead of using tariffs, a devaluation is undertaken which maintains a constant value of the import quota, the devaluation will transfer some of the import premia to government, the size of this depending upon the extent of the devaluation. If the devaluation is not sufficient to erode the entire import premia, then the domestic price of imports is unlikely to increase. It is likely that imports from the private sector will decline as real incomes fall due to a transfer to the government sector. The devaluation will change relative prices in the domestic economy. The effect on the trade account will depend on the price responsiveness of the export sector.

Thus, if a "narrow" liberalization programme is pursued, the use of a devaluation is more likely to contribute to an improvement in the trade balance than is the use of tariffs because of the relative price effects.

If the liberalization programme is pursued by increasing import volumes, the increase, *ceteris paribus*, will be accompanied by a decline in the level of domestic import prices as the excess demand is reduced. The reduction in import tariffs at the same time as restrictions on imports are being removed will be accompanied by a further decline in the domestic price of imports, encouraging, in turn, a further inflow of imports. The decline in the price of importables will cause an increase in relative prices and encourage a positive export supply response to the extent of dependence on the relative price change and the price responsiveness of the export sector. The trade balance position will be determined by the relative responsiveness of the exportables and importables sectors to the relative price changes.

A devaluation combined with removal of quantitative restrictions will increase the border price of imports and reduce the potential for decline in the domestic price of importables. The responsiveness of exports to the relative price change is crucial in alleviating the worsening of the trade balance due to liberalization.

It is expected that export sector responses to liberalization of the trade regime will be slower than the import demand response. The export supply response will depend on several factors. The existence of excess capacity and the degree of obsolescence of the machinery etc. are important in determining supply response. The larger the excess capacity, the greater the potential for a significant export response. Obsolete machinery which needs replacing will constrain the supply response. The availability of credit, especially working capital, is also important. The need to replace obsolete capital may increase the demand for credit by the export sector, and if this is not made available, it will constrain export supply. Bevan *et al.* (1987) have noted that if supply of consumer goods and imported inputs to the export sector is not increased when there is a relative price change, the export sector may not generate the expected positive supply response, if a shortage of these goods acts as a constraint on production. Fourth, if there is uncertainty regarding whether or not there will be a policy reversal, it is possible that trade liberalization will discourage rather than encourage exports. This is because potential exporters take into account the cost of moving in and out of a sector which is experiencing a change in incentives towards it. Uncertainty can also increase the demand for imports in the short run over and above what they should be. Individuals will increase purchases of imports if they expect that the liberalization phase will be reversed in the near future. The effect of this uncertainty causes the trade balance to worsen significantly, thus putting pressure on the authorities to reverse the policy (Rodrik, 1990).

Foreign investors would also wish to ensure that the liberalization programme as well as the macroeconomic package accompanying it will remain in place before investing resources in the economy. Thus, private long-term capital flows in particular may be slow to respond to the liberalization process. In fact, if there is a relaxation of exchange controls at the same time, the net effect may be an outflow of capital as individuals not certain whether the policy will be maintained will take advantage of the relaxation of controls. The most likely source of major capital inflow will therefore be from official sources in the short to medium term. This is especially so if the liberalization package were drawn up after consultation with the World Bank and IMF. It is necessary, within the context of economies that are liberalizing from a system of controls which has meant shortages of essential input requirements, to have adequate external financial resources to encourage the production of exportables as well as importables.

The responsiveness of both import demand and export supply to a liberalization programme will be determined also by the macroeconomic context within which the programme is introduced. Expansionary fiscal policy which increases domestic expenditures will encourage an increase in imports. If the policy results in increases in the money supply, this will contribute to fuelling inflation, thus causing the real exchange rate to appreciate (if there has been a once-and-for-all nominal devaluation). The appreciation of the real exchange rate will cause import demand to increase and export supply to decrease, thus causing the trade balance to deteriorate. If expansionary fiscal policy occurs when the narrow definition of liberalization is being pursued, excess demand will not be expressed by an inflow of imports but by an increase in domestic prices. The resulting inflation will reduce the competitiveness of the export sector and so reduce the incentive to export. It is necessary that macro-policy be pursued such that it regulates demand for imports to the capacity to import. Fiscal and monetary restraint are therefore necessary. However, in imposing monetary restraint it is necessary that the demand for credit from the export sector not be unduly constrained. This is because if the devaluation is associated with an increase in the price of imported inputs, there may be an increase in the demand for working capital in order to pre-finance the production process.

It is difficult to determine *a priori* what effect a trade liberalization programme will have on the balance of payments. If the liberalization is introduced when the current account is in deficit, it is almost certain that in the short run this deficit will widen because of the relatively slow response of the export sector to incentives as well as the need to increase the supply of imports in order to generate the required supply response from the export sector. In the medium to long term, however, as the programme is sustained, if the liberalization is accompanied by an explicit export promotion policy (and assuming international demand conditions do not deteriorate), the trade balance and current account position may improve. Whether or not the current account will go into surplus will depend upon whether the trade surplus will be large enough to finance the debt service on past loans which were incurred to finance and sustain the liberalization programme.

The controlled regime

Strict imports may result in a trade balance surplus being obtained; however, it will be at the cost of a decline in the openness of the economy if the effect of the controls is to discourage the export sector. As the export sector declines, controls on imports will be strengthened in order to maintain the trade surplus, and this will further reduce the incentive to export. Where the economy is import-dependent, this will reduce the growth of GDP.

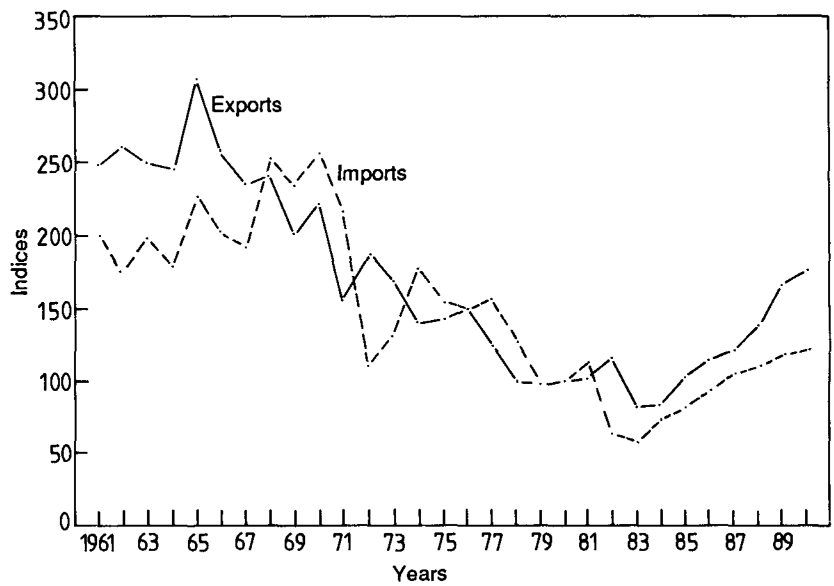
The overvalued exchange rate and exchange controls, which are usually features of a controlled regime, will discourage foreign direct investments and other capital inflows. This is likely to occur if the foreign exchange constraint becomes binding and economic agents realize that the currency programme of controls is not sustainable. A general characteristic of the structure of Ghana's balance of payments is that traditionally Ghana has always had a deficit on its services account. The changes in the current account position are determined primarily by the trade balance position and net official transfers.

Ghana has gone through two episodes of controlled regime, 1961-66 and 1972-82. During the two periods, virtually the same methods were used to regulate the flow of imports. An examination of the tables below shows that developments in the external account, however, differed for each of the time periods.

During periods of substantial smuggling characteristic of controlled regimes, official figures will not reflect total activity in the economy. Both official import and export values will be lower than the actual. However, if the non-official trade is balanced, since it has to finance itself, the official figures may still provide some indication of the overall effect of the regime.

In the first controlled trade regime episode of 1961-66, export volumes declined in three out of the six years (Figure 2). The sharp increase in volumes in 1965 was due to the very large cocoa harvest that year. Non-cocoa export performance was also poor during that period. The real exchange rate appreciated in the face of a fixed nominal exchange rate and rising prices, eroding export incentives. During this period there was no deliberate policy to encourage exports which could have counteracted the negative effect of the appreciation of the real exchange rate.

Figure 2 Export and import volumes indices (1985=100)



The major focus of trade policy was the control of and change in the structure of imports. Import volumes in the three years after the introduction of controls managed to stay below their 1961 levels (Figure 2). However, there was difficulty in staying within planned import levels because of the pressures of demand (Killick, 1978, p. 269). The expansionary fiscal policies pursued during the period were at odds with the objective of correcting the balance of payments disequilibrium. The large current account deficit of 1965 was due to the substantial increase in import values due largely to the rise in import volumes to accommodate the OAU conference (Table 16). Although cocoa export prices had declined significantly in that year, this was compensated for by the substantial increase in cocoa exports. Total export values, therefore, were hardly affected. The overall balance of payments however, was in surplus because of the substantial inflow of short-term capital in that year. These flows were not maintained in the following year so that there was a large balance of payments deficit in 1966. Even though the controls were able to improve the trade balance position, this was at the cost of a declining external sector. Given the import-dependent nature of the manufacturing sector in the Ghanaian economy, this did not portend well for manufacturing output in particular and overall growth in general. Between 1961 and 1966 the ratio of exports to GNP declined from 20.24% to 12.69% whilst the ratio of imports to GNP declined from 25.5% to 15.02%.

In the second controlled regime of 1972-82, in spite of fluctuations, the general trend was downward for both export and import volumes (Figure 2). Apart from the introduction of aluminium exports from Alco in 1967, there was very little diversification of the commodity structure of exports. An export promotion package was introduced in the 1973 budget and again in the 1978 budget. The promotion package was not adequate to reverse the effect of the overvalued exchange rate on the incentive to export. Utilization of export incentives involved having to overcome several bureaucratic hurdles which increased the cost to exporters. The import control system still in place contributed in no small part to these bureaucratic bottlenecks. The declining import volumes, which meant a decline in the supply of wage goods and imported inputs required by the export sector, further discouraged export production. Severe shortages of both domestically-produced goods and imports were experienced in the 1970s, and there was a need to set up special outlets to ration the supply of what was referred to at the time as "essential goods". Supplies of insecticides and spraying cans, for example, did not meet minimum requirements. Therefore, despite the existence of subsidies on inputs used in the cocoa industry, production declined and the quality of the tree stock deteriorated because the lack of adequate supply rendered the input subsidy ineffective. The declining real producer price relative to Ghana's neighbours also encouraged a diversion of exports to unofficial channels. The export sector therefore shrank further during this second period of controls from 20.36% of GNP in 1972 to 10.48% in 1977 and 3.32% in 1982.

Table 16 Balance of payments in the controlled regime (millions US$) 1960-66

	1960	1961	1962	1963	1964	1965	1966
Export values F.O.B.	333.8	332.5	319.9	307.0	321.4	321.2	280.3
Import values F.O.B.	348.1	384.7	310.1	336.6	321.5	439.4	320.7
Trade balance	-14.3	-52.2	9.8	-29.6	-0.1	-118.2	-40.4
Current account	-47.9	-103.5	-33.7	-80.1	-55.4	-222.9	-127.8
F.D.I.	3.9	-11.3	9.9	7.4	14.5	38.2	56.1
Long-term capital flows	104.1	97.6	40.4	55.4	42.6	45.6	46.6
Short-term capital	-11.1	-0.2	-4.4	-11.5	-8.8	144.5	-25.0
Overall balance	25.7	-21.8	4.1	-40.8	-4.2	15.2	-48.1
Reserves	272.2	150.3	176.1	203.7	119.9	110.2	105.5
Cocoa export volumes 1985=100	202	271	281	270	255	319	262
Cocoa beans price US cents/lb 1985=100	26.2	20.9	19.7	24.1	22.1	16.8	22.7

Despite the decline of the export base for the reasons outlined above, the trade balance was in surplus in all but two of the years during this period (Figure 3). The import control system was successful in constraining merchandise imports to the growth rate of merchandise export values. However, this meant that since the export sector was declining (due to the adverse impact of the policies of the controlled regime), the import base had to decline if a trade surplus were to be achieved. Thus, the ratio of imports to GNP declined from 13.47% in 1972 to 10.06% in 1977 and 2.5% in 1982. The decline in the import base is evident from Figure 2. The generally favourable terms of trade between 1972 and 1979 may explain why the trade balance was in surplus despite the faster fall in export volumes compared with import volumes.

A current account surplus was achieved in five out of the 11 years in which the controlled regime was in place (Table 17). The services account was always in deficit, with the size of the deficit increasing almost continuously during the period. Net private current transfers were in deficit except for 1975. Positive net official transfers reduced the size of the current account deficit. In two of the five years in which a surplus was achieved (1975 and 1980), this was because of the positive net official transfers. The current account surplus of 1972 was due to the sharp decline in import volumes which pushed import values down. The surplus in 1973 may be explained primarily by the increase in export values and the improved terms of trade in that year. During the period, however, there was a slow-down in the inflow of capital. The disbursement of long-term loans declined in 1973 and only began to increase again in 1975. The loan inflows were significantly lower than the levels obtained in 1961-66. This difference may be explained by the unilateral repudiation of some external loans in 1974. Thus, the overall balance of payments surplus experienced in some years was due more to the trade balance surplus in those years than to capital inflows. This situation was not sustainable given the low export and import base and the constraints within the domestic economy because of the insufficient supply of imports.

Figure 3 Balance of trade

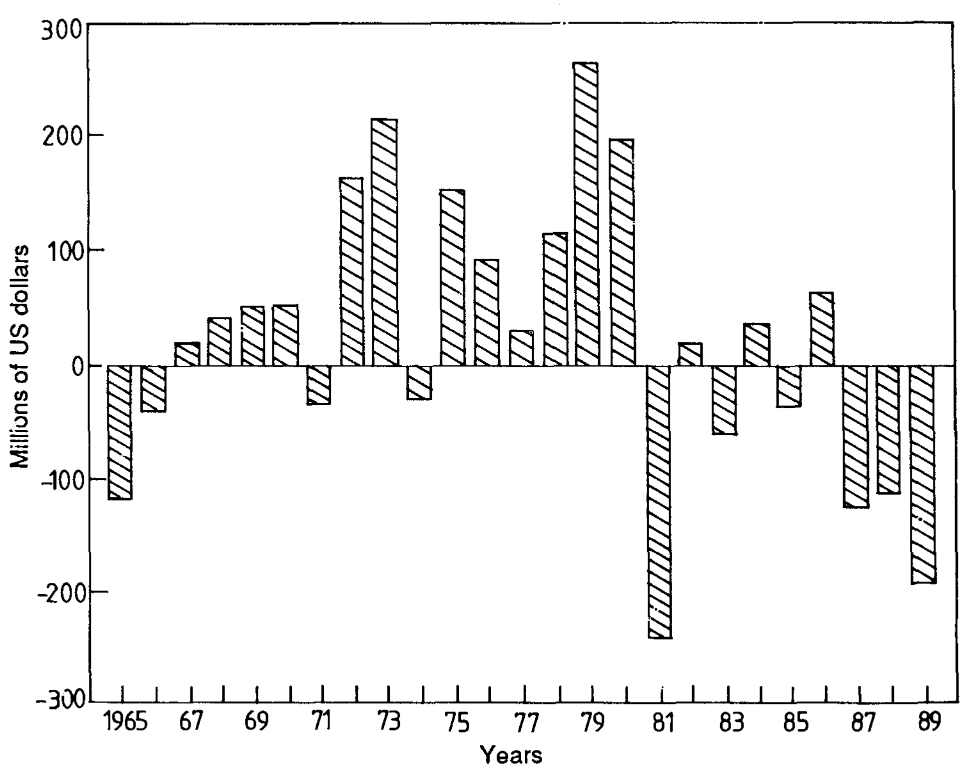


Table 17 Balance of payments in the controlled regime, 1972-82 (millionsUS$)

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Exports fob	334.6	384.3	585	679	801	779	889.6	892.8	1065.7	1103.6	710.7	607.0
Imports fob	368.2	222.9	372.1	708.2	650.5	690.3	860.2	780.3	803.1	908.3	954.3	588.7
Trade balance	-33.6	161.4	212.9	-29.2	150.4	88.8	29.4	112.5	262.6	195.3	-242.6	18.3
Services (net)	-112.5	-66.5	-98.7	-166.4	-177.4	-189.7	-167.6		-219.4	-245.7	-260.2	-209.4
CA Balance before official transfers	-154.9	92.1	107.9	-199.3	-2.7	-105.1	-144.4		40.6	-53.7	-508.0	-192.3
Net official transfers	9.0	16.2	18.8	27.8	20.3	31.0	64.6		81.4	82.9	87.2	83.7
Current account	-145.8	108.2	126.7	-171.5	17.0	-74.0	-79.7	-45.9	122	29.2	-420.8	-108.6
FDI	30.6	11.5	14.4	10.5	70.9	-18.3	19.2	9.7	-2.8	15.6	16.3	2.4
LTCF (net)	34.4	29.7	17.0	-2.0	21.6	4.9	69.7	83.9	54.2	19.6	77.1	111.8
Disbursements*	37.9	41.5	32.1	31.1	31.1	44.8	100.4		79.4	98.1	81.3	58.2
CTCF	32.2	-121.8	-40.5	34.6	-10.0	-23.1	-30.0	25.7	-31.7	5.8	14.7	3.6
Overall balance	34.7	33.1	109.1	-142.0	106.3	137.3	-8.5	-46.0	35.6	-30.1	-288.7	9.6
International reserves	36.1	93.7	176.1	71.5	124.7	91.7	148.6	277.2	289.1	180.4	145.6	138.9
Cocoa volumes (1985=100)	216	263	295	205	193	196	151	128	113	154	109	134
Cocoa value US cents/lb (1985=100)	23.8	28.3	56.4	88.9	64.0	102.9	198.1	156.5	146.8	117.6	94.0	79.3

LTCF = long-term capital flows; STCF = short-term capital flows; * = long-term loans
Sources: IMF *IFS Yearbook*, 1990; IMF *BOP Statistics*, Vol. 41, No. 11, November 1990; World Bank, *Trends in Developing Countries*, 1990.

The devaluation of 1978 was not accompanied by restraint in expenditures. The decline in import volumes may be explained more by the binding constraint of the import licensing on import demand. The increase in export values between 1978 and 1980 can be explained by the export price changes during that period. The increase in the producer price of cocoa in that year suggested that there was a full pass-through of the devaluation to the cocoa farmers. However, the devaluation was not enough to reverse the decline in the real producer price of cocoa. Import volumes declined at the same time, suggesting that the import constraint on the export sector was still binding. The trade surplus of the year of the devaluation and the following year was the result of the effectiveness of the import control system rather than due to a positive supply response to the devaluation. Export values did not change significantly. Volumes were actually lower in 1978 and 1979 compared to 1977.

There was a sharp drop in cocoa prices in 1981, not long after the doubling of oil prices in 1979-80. Cocoa volumes also declined in that year. Total export values declined sharply. Import volumes increased at the same time, causing the trade balance to go into deficit. International reserves which had been declining since 1979 declined further still so that in 1981 they covered less than three months of imports.

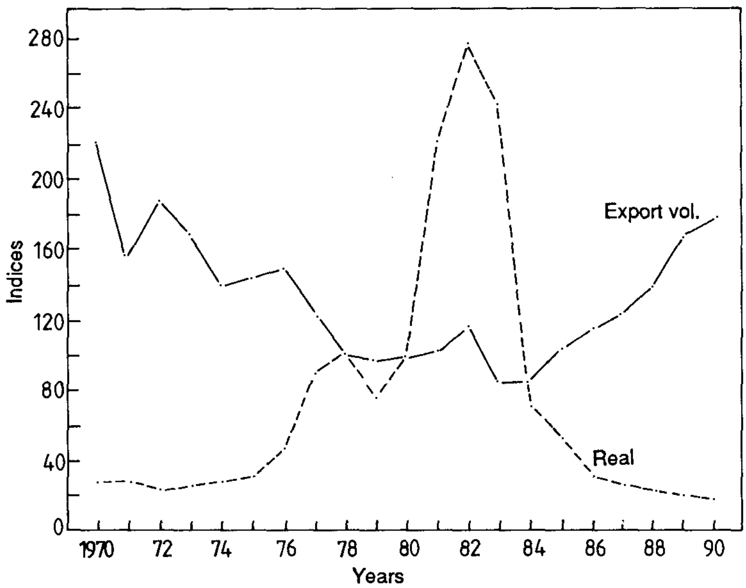
The further decline in cocoa prices in 1982 despite the increase in export volumes caused values to decline. Import volumes were severely constrained so that a trade surplus was achieved. Despite the trade balance surplus, a large deficit in the service account existed, and there was a fall in net official transfers, thus maintaining the current account deficit. However, capital inflows were insufficient to finance the current account deficit. International reserves declined further.

Government expenditures increased almost continuously during this period. Despite the rising rate of inflation, the level of real domestic absorption declined in 1972, increased in 1973-74 and remained above its 1972 level for most of the period. In most cases a greater proportion of the increase in real absorption was due to increases in government consumption. The expansionary fiscal policy of the government would have worsened the trade balance if the import control system had not been in place. As a result of the control system, excess demand expressed itself in increases in the prices of goods in the domestic market as well as through the import of items through unofficial channels.

By the end of the ten-year period the size of the overall balance of payments deficit was small in nominal terms compared with the previous period of liberalization and the trade balance was in surplus. However, the shrinking size of the external account and its adverse implications on output, government revenues and inflation meant that a change in policy was definitely required.

There is no clear-cut relationship between the trade balance and the controlled regime (Figure 3). In the first period, the trade balance was, on average, in deficit, while in the second period it was in surplus. The difference could be explained largely by the terms of trade. In both instances there was a failure to improve export performance. The appreciation of the real exchange rate during this period is an important explanatory variable. This is evident from Figure 4 which maps the real exchange rate and export volumes. The poor performance of the export sector in both periods suggests that the situation was not sustainable since foreign exchange availability was not improving.

Figure 4 Exports volume and real effective exchange



Liberalized regime

During the first liberalization phase, the government had pursued deflationary fiscal and monetary policies and devalued the exchange rate before a liberalization of the import trade regime began. The devaluation was passed through fully to the exporters through increases in the producer prices in those cases where these prices were determined administratively. On the import side, the devaluation was accompanied by a price increase of about 55% of the gross devaluation during the succeeding six months (Leith, 1974, p. 118).

The liberalization of the trade regime began in 1968 with an increase in a number of goods which could enter using the OGL. There was a sharp increase in import volumes in 1968; hereafter, they declined in 1969, rose in 1970 and fell in 1971 (Figure 2). Nominal import values between 1967 and 1969 actually remained below their values during the period of controls. Real domestic absorption increased continuously after 1968, and the real exchange rate was eroded by inflation. The fact that import volumes did not increase substantially would suggest that the import licensing system still in place was important in explaining the movement in import volumes.

The performance of the export sector did not improve during this period. There was a significant downward trend in export volumes (see Figure 2). Export values, however, increased due to increased cocoa prices between 1967 and 1969 (Table 18). It has been suggested that the increase in producer prices following the devaluation was not enough to encourage new plantings which would encourage long-run supply (Leith, 1974). The real value of the nominal devaluation was eroded because of price increases in the domestic economy. In an analysis of the response of the non-cocoa sector to the devaluation it was found that there was a slower response than expected (Leith, 1974, p. 131). The incentive programme introduced in the 1969-70 budget was constrained by bureaucratic and implementation bottlenecks. The appreciation of the real exchange rate eroded the subsidy equivalent of the export promotion package. Given the inability to generate a surplus on the trade account, it would have been necessary to devalue the currency earlier than was indeed the case, i.e. before 1971.

The failure of the liberalization programme was the failure to encourage a positive growth of exports. Import volumes could have been restrained further but this would have been at the expense of domestic growth. The continuous increase in real domestic absorption during this period suggests that greater fiscal and monetary restraint was required than actually prevailed (Leith, 1974; Ofori-Atta, 1975).

The objective of the present liberalization programme is to improve the external account position of the country as well as reduce the bottlenecks and constraints on output growth due to foreign exchange shortages. An expansion of both import and export programmes was thus the objective of the liberalization programme. There was a change in the effective exchange rate in April 1983 through the system of surcharges and bonuses. Although government expenditures increased by 51%, the sharp increase in prices during this period caused real domestic absorption to decline.

Table 18 Balance of payments in the liberalized trade regime, liberalization I, 1967-71

	1965	1966	1967	1968	1969	1970	1971
Export fob	321.2	280.3	284.2	304.4	345.0	427.0	334.6
Import fob	439.4	320.7	265.4	264.6	295.3	375.1	368.2
Trade balance	-118.2	-40.4	18.8	39.8	49.7	51.9	-33.6
Services (net)						-117.9	-112.5
C.A. balance before official transfers						-76.0	-154.9
Net official transfers						8.3	9.0
Current account	-222.9	-127.8	-84.9	-56.1	-60.1	67.7	-145.8
F.D.I.	38.2	56.1	32.5	15.8	10.2	67.8	30.6
LTCF (net)	45.6	46.6	19.5	15.9	40.6	34.3	34.4
Long-term loan disbursements						41.8	37.9
STCF (net)	144.5	-2.5	-44.1	16.6	16.4	-48.5	32.2
Overall BOP	15.2	-48.1	-72.3	-6.5	-26.9	2.5	-34.7
Reserves	110.2	105.5	77.1	90.3	66.2	36.6	36.1
CCV 1985=100	319	262	220	220	204	242	216
Cocoa beans price US cents/lb 1985=100	16.8	22.7	29.82	34.78	45.22	33.26	25.65

Notes: CCV = cocoa volumes; FDI = foreign direct investment; LTCF = long-term capital flows (not including FDI); STCP = short-term capital flows
Source: as in Table 16

Import volumes increased continuously between 1983 and 1990 (Figure 2). This may be explained by the positive income growth rates experienced during the period as well as by the sizeable capital inflows in those years compared with previous years. Despite the large depreciation of the currency between 1983 and

1986, domestic prices did not increase by as much as the gross devaluation. This may be explained by the existence of the black market and the fact that most goods prices were determined by the black market rate. Although aggregate demand was increasing during that time, the positive increase in output also contributed to counteracting the effect of the devaluation on domestic prices. It is possible that without the maintenance of import licensing during this period, import demand would have increased further than it did.

A significant proportion of the devaluation was passed through to the cocoa sector through increases in the producer price which were able to reverse the decline in real prices. Both cocoa and non-cocoa export volumes have taken some time to respond to the change in incentives associated with the liberalization programme (Figure 2). The sharp devaluations increased the price of imported inputs. The response to changes in price incentives by those activities which did not have excess capacity or modern machinery was constrained in the short-run. There would be a need for access to working capital to finance the increased cost of input and capital imports in order to respond to the devaluation. Credit to finance the export trade fell in 1983 and 1984 compared with their values in the early 1980s. It was not until 1985 that credit increased above the 1980 levels. Uncertainty as regards whether or not the liberalization programme would be reversed lengthened the decision and implementation lag of economic agents. Despite the initial sluggish response of the export sector, the growth of export volumes has picked up since 1987.

Import volumes responded faster to the new set of incentives than did exports (Figure 2). Between 1983 and 1986 the devaluation reduced the differential between the official and parallel market exchange rates. Since most imports were priced at parallel market rates, the devaluation did not affect import prices significantly. Imports increased as pent-up excess demand for both consumer and producer goods was satisfied with the relaxation of quantitative restrictions. Figure 1 indicates a slow-down in the rate of annual percentage change in import volumes since 1987. This may be because it is only since 1987 that the price effect of the devaluation has had an impact on import demand. Credit to finance the import trade increased significantly between 1983 and 1986 in both absolute and relative terms. There has been a slow-down in the growth of credit going to finance imports since 1987, and this may also be important in explaining the slow-down in the growth of import volumes. The trade deficit during most of the period 1983-89 may be explained by the decline in terms of trade and not necessarily because of a failure of export sector performance to improve.

The service account has been in deficit throughout the entire period. The size of the current account deficit has been reduced substantially by net official transfers. In some years the effect of these transfers has been to reduce the size of the current account balance before official transfers by more than 50%, e.g. in 1984 and between 1986 and 1988. The result is that the ratio of the current account balance after official transfers to GNP have declined since 1983 from 5.12% to 2.05% in 1984. In 1988 it was estimated at 2.02%. Apart from grants, the programme has also experienced a substantial inflow of loans. The inflow of long-term loans almost doubled between 1983 and 1984 and doubled again between 1985 and 1986 (Table 19). The inflows of long and short-term capital have allowed the overall balance of payments to be in surplus despite the large current account deficits recorded (Table 19). The result has been substantially larger holdings of international reserves compared with what was available during the first liberalization phase. The liberalization programme, apart from encouraging inflows of loans from official sources (both bilateral and multilateral), has also encouraged the inflow of private transfers by Ghanaians resident abroad.

The first liberalization episode was characterized by an appreciating real exchange rate. This can explain its failure to stimulate exports in contrast with current liberalization which is characterized by a depreciating real exchange rate. Figure 4 illustrates rather dramatically the importance of the real exchange rate in explaining developments in export volumes. This has also been confirmed in econometric estimates of the relationship between the exchange rate and export performance (Jebuni, Sowa and Tutu, 1991). Export performance has improved significantly during the present phase compared with the previous. Differences in the initial conditions and the manner in which the liberalization has been pursued may also be important in explaining the differing export performance between the two liberalization episodes. In the present episode, liberalization was introduced when the economy was heavily distorted, probably more so than was the case in the former period. The high incidence of cocoa smuggling and the large gap between the parallel and official market rates (compared with the relatively smaller divergence in the period 1967-71) may be indicative of the extent of distortion in the economy in 1982. Thus, the export response (as recorded in official statistics) of the cocoa sector was definitely not entirely made up of production changes but also composed of a diversion of cocoa from unofficial to official channels as a result of the improvement in the real official price of cocoa.

Table 19 Liberalization Phase II, 1983-89

	1982	1983	1984	1985	1986	1987	1988	1989
Export FOB	607.0	439.1	565.9	632.4	773.4	820.8	881.0	807.2
Import FOB	588.7	499.7	533.0	668.7	712.5	951.5	993.4	-999.0
Trade balance	18.3	-60.6	32.9	-36.3	60.9	-124.7	-112.4	-191.8
Services (net)	-209.4	-185.9	-234.0	-240.0	-298.5	-297.0		
C.A. balance before official transfers	-192.3	-248.3	-180.0	-243.7	-165.5	-220.1	-263.6	
Net official transfers	83.7	74.2	141.2	109.5	122.5	123.2	173.7	
Current account	-108.6	-174.1	-38.8	-134.2	-43.0	-96.9	-65.8	-97.5
F.D.I.	2.4	2.4	2.0	5.6	4.3	4.7	5.0	15.0
LTCF (net)	111.8	31.4	202.2	39.5	142.0	227.0	178.59	187.6
Long-term loan disbursements	97.8	172.9	117.8	181.1	360.6	326.1	330.9	
STCF (net)	3.6	93.3	2.7	39.8	-82.9	23.4	25.1	33.4
Overall BOP	-9.6	-172.9	35.6	14.1	-60.8	140.2	181.1	155.6
Reserves minus gold	144.8	301.6	478.5	573.0	195.1	221.3	347.3	
CCV 1985=100	134	104	91	100	128	130	132	162
Cocoa beans price US cents/lb 1985=100	79.3	94.2	107.6	100.0	91.8	87.0		

Notes: CCV = cocoa volumes; FDI = foreign direct investment; LTCF = long-term capital flows (not including FDI); STCP = short-term capital flows.
Source: as in Table 16.

However, in contrast to the period 1967-71 when the trade account was always in surplus, current liberalization has been characterized by the tendency for the trade balance to be in deficit. This could be explained, to a large extent, by the differences in external support. High levels of external support in the current programme have allowed the economy to maintain levels of imports substantially above exports.

Both liberalization episodes have been associated with positive movements in import volumes. There has been a consistent increase in import volumes during the present programme compared with the previous one. Liberalization with or without real depreciation of the currency tends to increase imports. This is because liberalization in both cases was preceded by a period of controls and excess demand within the domestic economy.

Comparison of trade regimes

The different regimes cannot be differentiated on the basis of their effects on the trade balance position. The first liberalization episode improved the trade balance compared with the controlled period preceding it. The current episode is characterized by trade deficits in most years, compared with the trade surpluses of most years during the controlled trade regime preceding it.

The controlled regimes have been able to constrain the growth of import flows but have not always been successful in achieving planned levels because of the failure to constrain aggregate demand effectively to achieve their objectives on the external account.

Both regimes are characterized by a failure to encourage positive export growth rates. This has contributed to putting the controlled regime in jeopardy. However, the first liberalization episode did not reverse the downward trend in export volumes. This indicates that import liberalization on its own is not sufficient to encourage exports without a definite and effective export promotion policy as well as an exchange rate policy which prevents overvaluation of the currency.

Commodity composition of imports

The import control system has been used as a tool to obtain the government's objective of industrialization through import substitution. This was begun in the 1960s through a deliberate change in the commodity structure of imports using the import licensing system. There was a significant decline in the share of consumer goods and an increase in the share of producer goods between 1961 and 1966. By 1966 consumer goods imports were equivalent to 30.9% of total imports compared with 49.4% in 1961, while the share of producer goods rose from 46.4 to 64.8% in the same period. It is not clear to what extent this decline in consumer goods affected the supply of wage goods to the rural sector and so affected the incentive to produce cash crops for both the domestic and external market.

The liberalization of 1967-71 was not accompanied by a change in the structure of imports. This may be because the import licensing system was still in operation to achieve government policy objectives.

The policy concerning the import structure was maintained during the second period of controls. The shift in the commodity composition of imports from consumer goods to producer goods which was begun in the 1960s was maintained in the 1970s. However, major determining factors of the commodity composition of imports during this period were the two oil price increases in the 1970s.

Table 20 Commodity composition of imports by end-use

Year	Consumer goods	Fuels and lubricants	Producer goods
1961	49.40	4.20	46.40
1962	39.40	5.53	55.02
1965	34.33	4.01	61.64
1966	30.90	4.22	64.88
1967	32.83	5.89	61.29
1968	28.25	7.75	63.40
1969	30.20	6.34	63.40
1970	30.10	5.74	64.10
1971	23.39	6.02	65.85

Source: Central Bureau of Statistics, *Economic Survey*

It had been projected in the five-year plan for the period 1975-80 that there would be a gradual decline in the share of consumer goods to about five percentage points below the 1975/76 shares by the end of the plan period (Table 21). The share of fuels and lubricants was expected to decline by about one percentage point during the plan period. The decline in the share of consumer goods would allow for an increase in the share of producer goods in total imports. However, as the following discussion on actual commodity shares will show, the plan projections were not realized in their entirety.

Table 21 Composition of planned imports in the Five-Year Plan 1975-80

Year	Consumer goods	Fuels and lubricants	Producer goods
1975/76	23.1	17.1	59.8
1976/77	23.1	16.7	60.2
1977/78	21.7	16.4	61.9
1978/79	20.1	16.3	63.6
1979/80	18.1	16.1	65.8

Source: Republic of Ghana, 1977, p.70

The trend for the period 1972 to 1982 has been for fuels and lubricants to make up an increasing proportion of total imports (Table 22). The share of this item in total imports between 1977 and 1980 was significantly greater than what had been projected in the five-year plan. Until 1978 the increase in the share of petroleum products was primarily at the expense of imports of consumer goods (Table 22). In 1977 for example, the share of consumer goods declined to 13.95% of the total. The share of consumer goods remained fairly stable between 1972 and 1975 except for a dip in 1974, the year the oil prices tripled. After 1975, the proportion of producer goods in total imports increased continuously until 1978 when it declined by five percentage points. In 1976 and 1977 the share of producer goods was actually greater than what had been planned for that period. Both the share of fuel and lubricants and producer goods declined in 1978 allowing a significant increase in the share of consumer goods. With the second oil price increase in 1979-80, however, the upward trend in the share of this commodity group declined significantly after 1978 (Table 22). Fuel and lubricants increased in importance with their share increasing to 35% in 1982. Consumer goods imports also gained at the expense of producer goods in the period 1980-82.

In 1983 there was a sharp increase in the share of consumer goods imports into the economy compared with their 1982 shares. This was a continuation of the pattern which began in 1980. The increase in 1983 in the share of consumer goods imports can be explained by the increase in absolute values of imports of durable goods (not including private vehicles). Their share increased from 5% of consumer goods imports in 1982 to 15.63% in 1983. Interestingly enough the share of food imports in consumer goods imports declined in that year. Petroleum imports share of total imports declined significantly in that year to 10% of the total. As a result of this, the share of producer goods imports increased considerably (Table 23).

Table 22 Commodity composition of imports, 1972-82

Year	Consumer goods	Fuels and lubricants	Producer goods
1972	24.7	11.5	63.8
1973	27.9	8.8	63.2
1974	23.84	16.36	59.8
1975	20.3	16.6	63.1
1976	20.94	14.94	65.14
1977	13.95	18.67	68.18
1978	23.24	13.65	63.10
1979	18.11	20.61	61.20
1980	17.06	26.66	56.28
1981	20.5	30.59	48.8
1982	20.9	35.6	43.47

Source: 1972-80 obtained from various issues of *Economic Survey*; 1980-82 supplied by the Statistical Services Department.

During the transitional period of 1983-85 the pattern begun after 1979 continued, i.e., there was a decline in the share of producer goods. This however, was reversed in 1986. The liberalization period of 1986-88 has been accompanied by a surge in the share of consumer goods.[5] However, despite liberalization there has not been any significant change in the structure of imports, that is, producer goods still constitute the larger share of total imports.

Table 23 Commodity composition of imports

Year	Consumer goods	Fuels and lubricants	Producer goods
1983	29.72	10.11	60.16
1984	19.24	34.73	46.01
1985	25.49	29.2	45.29
1986	31.71	15.45	52.84
1987	40.60	13.99	45.41
1988	23.14	15.03	61.83

Source: supplied by Ghana Statistical Services.

IV Liberalization and fiscal performance

As discussed in an earlier section, one of the main considerations affecting exchange rate and trade policy in Ghana is the fiscal deficit. In recent works Greenaway and Milner (1993) and Rodrik (1990) have emphasized the revenue and therefore budgetary implications of the trade reform as crucial in ensuring its sustainability. It is argued that in view of the importance of trade taxes in developing countries, when trade reform is undertaken it should be implemented primarily with an eye towards alleviating the fiscal crisis. Fiscal deficit as used here is based on the conventional definition which measures the difference between total government cash outlays including interest outlays (but excluding amortization payments) and total cash receipts (including tax and non-tax revenue and grants but excluding borrowing proceeds). This definition is on a cash basis as distinct from the accrual concept.[6] However, there is no analysis of the relationship between trade and payments regime and the fiscal deficit in Ghana.

At the theoretical level liberalization can be expected to have important implications for government revenue, expenditure and the fiscal deficit. Theory suggests that the effect of the trade regime on the budget may depend on the direct impact on trade tax revenues and the economy's response to the changes in relative prices. Tanzi (1989) has provided an inventory of the positive and negative effects of trade liberalization with a devaluation on tax revenue. Liberalization with a devaluation may have a positive effect on tax revenues through:

- the replacement of quotas and other quantitative restrictions by tariffs;
- reduction of duties from the prohibitive to a more normal range;
- putting low tariff on previously exempted goods (in a situation where exempted goods form a large share of imports perhaps due to import-substitution industrialization policy, this change is potentially very important in terms of revenue yield);

- increase in the value of imports and in the domestic prices of imported products because of the devaluation;
- the likely reduction in smuggling;
- some positive effects associated with a possible change in the composition of imports in favour of the decreased incentive to bias imports towards imports of raw materials and intermediate products;
- some positive effects on tradable output, especially over the medium-run, associated with devaluation and the liberalization policy.

Among the negative effects on tax revenue, Tanzi recognizes the possibility that, at least for some imported products, the continuation of price increases due to devaluation and price reductions due to the reduction in import duties may result in a reduction in tax revenue. Over the short-run trade liberalization with devaluation may reduce output and employment in some sectors (especially import-substituting sectors) enough to have a negative impact on tax revenue. On the whole, however, Tanzi argues that trade liberalization with devaluation would increase tax revenue and possibly improve the fiscal balance. However, as Cheasty (1990) argued, the extent of these effects will depend on the price elasticity of demand for imports, income-related effects, the elasticity of substitution among imports, the market structure of import trade, the public's perception of liberalization and the response of the economy.

Empirical evidence from Africa and Latin America suggests that there is no clear cut relationship between trade taxes and trade reform (Greenaway and Milner, 1993).

One of the main effects of a devaluation will be an increase in the domestic currency value of any external debt. This will contribute to an increase in government expenditures which may have adverse implications for the budget position. Additionally, in the presence of dual foreign exchange markets (i.e. official and parallel markets) additional expenditure-increasing channels may exist. Pinto (1989) has argued that there might be a trade-off between inflation and the black market premia. The black market premia might act as a means of taxation of the export sector. A devaluation narrowing the gap between the two may result in fiscal deficit as government expenditure increases if government is a net buyer of foreign exchange. This may also be inflationary as the government resorts to monetizing the deficit.

Structure of government revenue

Throughout Ghana's post-independence history, except for 1981 and 1982, taxes on international transactions have been the most important source of government revenue. For the entire period between 1965 and 1980, taxes on international transactions have contributed on average over 40% of government revenues (Table 24). The absolute importance of international transactions declined during the Economic Recovery Programme period 1984-89, even though they still remain as the topmost revenue earner for the government (Table 24). The period 1981-82 is the exception, marking the complete collapse of the economy. Tax revenue records for this period are also incomplete. Within taxes on international transactions, the relative importance of export and import taxes fluctuate.

Table 24 Structure of government revenue, 1965-88

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
Taxes on international transactions	0.45	0.39	0.40	0.42	0.45	0.55	0.52	0.43	0.36	0.44	0.53	0.37
Export duties	0.07	0.07	0.14	0.24	0.30	0.36	0.27	0.29	0.20	0.27	0.35	0.22
Import	0.38	0.32	0.26	0.19	0.18	0.19	0.25	0.14	0.16	0.17	0.17	0.15
Taxes on domestic goods and services	0.22	0.26	0.25	0.24	0.22	0.19	0.23	0.22	0.25	0.22	0.17	0.28
Taxes on income and property	0.20	0.23	0.21	0.21	0.20	0.15	0.15	0.21	0.23	0.20	0.21	0.24
Total tax revenue	0.88	0.89	0.86	0.87	0.90	0.89	0.90	0.87	0.84	0.86	0.90	0.88
Non-tax revenue	0.12	0.11	0.14	0.13	0.10	0.11	0.10	0.13	0.16	0.14	0.10	0.12
Grants	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.01	0.00	0.00

Table 24 cont ...

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Taxes on international transactions	0.40	0.36	0.61	0.44	0.28	0.18	0.49	0.38	0.41	0.43	0.43	0.35
Export duties	0.24	0.21	0.48	0.31	0.07	0.05	0.30	0.23	0.24	0.22	0.26	0.17
Import	0.16	0.17	0.13	0.13	0.22	0.13	0.19	0.15	0.17	0.20	0.17	0.18
Taxes on domestic goods and services	0.31	0.29	0.16	0.28	0.39	0.36	0.17	0.26	0.22	0.31	0.26	0.25
Taxes on income and property	0.20	0.21	0.14	0.21	0.25	0.33	0.17	0.18	0.20	0.23	0.22	0.28
Total tax revenue	0.91	0.90	0.93	0.93	0.92	0.96	0.83	0.82	0.82	0.97	0.91	0.88
Non-tax revenue	0.09	0.10	0.07	0.07	0.08	0.13	0.17	0.18	0.18	0.13	0.09	0.11
Grants	0.03	0.01	0.00	0.02	0.01	0.01	0.01	0.04	0.04	0.06	0.06	0.08

Next in importance in terms of government revenues are taxes on domestic goods and services. They are then followed by taxes on income and property. Even though the ranking of grants from abroad in terms of contribution to government revenue has remained the same throughout the period, its percentage contribution has varied widely. From an insignificant contributor, it accounted for 7.5% of government revenue in 1988. In the short to medium-term the structure of government revenue, regarding the relative importance of various components, reflects the structural features of the economy. This for the Ghanaian economy reflects the dominant role of agriculture, the importance of cocoa taxes and taxes on imports.

Most agriculture consists of smallholder farms and livestock farming which are not taxed. Cocoa, which is the largest single source of government revenue, contributes only 7.9% of GDP and 10% of agricultural output. Thus, about 40% of GDP originating from the non-cocoa agricultural sector is not taxed directly. This agricultural sector is also the least dependent on imports.

Government revenues, expenditures and fiscal balance

In July 1967, the currency was devalued and an austere budget introduced. In response, government tax revenue increased by almost 17% in 1967 and continued to increase until 1970. There were increases in most sources of government revenue. However, increases occurred to a large extent as a result of the increase in revenue from taxes on international transactions. For the period 1967 to 1970 real revenue from international transactions increased by 23% in 1967, 13% in 1968, 18% in 1969 and by 16% in 1970 (Tables 25 and 26). Most of the increase was due to increased revenue from export taxes on cocoa. Revenue from taxes on imports actually declined in 1967 and 1968 but picked up in 1969. In 1971, as a result of the continuing import liberalization, government revenue from taxes on imports increased by 26%. However, because of a substantial fall in world cocoa prices, revenue from cocoa export duties declined. As a result, overall government tax revenue declined by 5%.

In response to the higher import prices consequent upon the devaluation, import volume decreased and, as a result, real revenue from taxes on imports declined by 2% in 1967 and 22.8% in 1968. However, with the import liberalization programme in 1969 and the appreciation of the real exchange rate, import values and revenues increased. Compared with a decline in real government tax revenue of 28% and 29% in real total revenue, both government tax revenue and total revenue increased continuously throughout the liberalization phase 1967 to 1970 as shown in Table 25.

Table 25 Percentage changes in government revenue, 1966-1988

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
Taxes on international transactions	-0.38	0.23	0.13	0.18	0.46	-0.11	-	-0.20	0.43	0.15	-0.51
Export duties	-0.32	1.43	0.81	0.31	0.55	-0.30	-	-0.32	0.56	0.25	-0.58
Import	-0.39	-0.03	-0.23	0.00	0.32	0.26	-	0.04	0.26	-0.02	-0.39
Taxes on domestic goods and services	-0.17	0.17	0.01	-0.04	0.10	0.11	-	0.09	0.03	-0.27	0.15
Taxes on income and property	-0.19	0.07	0.06	0.03	-0.03	-0.07	-	0.01	0.04	-0.02	-0.21
Total tax revenue	-0.28	0.17	0.08	0.08	0.26	-0.05	-	0.12	0.01	0.00	-0.18
Non-tax revenue	-0.36	0.61	-0.04	-0.21	0.43	-0.10	-	0.12	0.01	-0.28	-0.18
Grants	-	-	-	-	-0.51	0.01	-	-1.00	-	-0.85	-1.00
GDP	-0.10	0.10	0.02	0.10	0.10	0.02	-	0.06	0.12	-0.13	-0.21
CPI	0.15	-0.10	0.11	0.06	0.03	0.09	-	0.17	0.19	0.30	0.55
Total revenue	-0.29	0.22	0.06	0.05	0.28	-0.06	-	-0.05	0.18	-0.04	-0.31

Table 25 cont ...

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Taxes on international transactions	-0.34	-0.22	0.93	-0.46	-0.68	-0.27	1.73	0.19	0.74	0.38	0.19	0.16
Export duties	-0.32	-0.38	1.73	-0.51	-0.89	-0.18	5.20	0.16	0.68	0.24	0.37	-0.31
Import	-0.36	-0.24	0.05	-0.29	-0.14	-0.31	0.44	0.23	0.82	0.57	-0.01	0.08
Taxes on domestic goods and services	-0.3	0.33	0.33	0.31	0.30	0.07	-0.52	1.28	0.36	0.90	-0.03	0.02
Taxes on income and property	-0.48	-0.23	-0.19	0.06	-0.39	0.53	-0.48	0.66	0.74	0.52	0.14	0.29
Total tax revenue	-0.56	-0.31	0.25	-0.24	-0.50	-0.09	0.05	0.51	0.62	0.55	0.11	0.003
Non-tax revenue	-0.56	-0.19	0.13	-0.28	-0.04	0.92	0.26	0.59	0.59	-0.78	2.68	0.30
Grants	-	-0.98	-1.00	error	-0.51	-0.11	-0.51	10.48	0.61	0.92	0.12	0.46
GDP	-0.21	0.09	-0.13	0.01	-0.22	-0.03	-0.04	0.05	0.11	0.23	0.04	0.08
CPI	1.17	0.73	0.55	0.50	1.17	0.22	1.23	0.40	0.10	0.25	0.40	0.31
Total revenue	-0.39	-0.30	0.21	-0.24	-0.49	0.16	-0.004	0.53	0.61	0.32	0.18	0.03

Table 26 Government revenue, 1965-1988 (millions of 1980 cedis)

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
Taxes on international transactions	4738.67	2933.48	3607.11	4076.52	4807.33	7033.41	6274.40	4382.93	3506.25	5021.05	5756.76	2776.52
Export duties	762.07	520.19	1263.76	2283.87	2998.87	4637.50	3260.38	2914.63	1975.00	3089.47	3871.62	1631.30
Import duties	3976.59	2413.29	2343.32	1808.77	1808.85	2384.91	3014.08	1468.29	1531.25	1931.58	1885.14	1145.22
Taxes on domestic goods and services	2382.15	1960.55	2291.93	2318.77	2227.73	2450.76	2726.59	2219.57	2420.83	2496.49	1831.08	2100.87
Taxes on income and property	2138.81	1740.90	1862.89	1978.65	2031.33	1977.85	1831.84	2178.05	2208.33	2303.51	2250.00	1778.26
Total tax revenue	9259.63	6634.94	7761.93	8373.96	9066.39	11451.03	10832.89	8780.49	8135.42	9821.05	9831.08	6655.65
Non-tax revenue	1252.30	795.23	1277.46	1228.35	969.70	1388.24	1245.95	1358.54	1527.08	1540.35	1110.81	907.83
Grants	0.00	0.00	0.00	0.00	18.18	8.82	8.92	85.37	0.00	82.46	12.16	0.00
GDP	54296	48968	53714	54839	60576	66441	67595	68659	72958	81754	71392	56748
CPI	2.70	3.10	2.80	3.10	3.30	3.40	3.70	4.10	4.80	5.70	7.40	11.50
Total revenue								10139.02	966.5	11361.40	10941.89	7563.48

Table 26 cont ...

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Taxes on international transactions	1842.57	1246.17	2409.61	1303.60	417.37	306.65	838.45	998.26	1734.00	2392.82	2843.2	2392.88
Export duties	1110.44	387.47	1876.88	926.10	101.66	83.12	515.73	600.81	1008.95	1252.70	1718.13	1182.49
Import duties	732.13	558.70	532.73	377.50	324.71	223.53	322.79	397.39	725.05	1140.12	1125.14	1210.39
Taxes on domestic goods and services	1411.65	948.49	633.78	831.60	583.37	624.55	297.69	678.40	921.01	1753.64	1704.74	1746.05
Taxes on income and property	925.30	707.89	575.23	611.30	370.81	567.33	293.14	487.03	847.43	1292.20	1477.73	1908.13
Total tax revenue	4179.52	2902.55	3619.52	2746.50	1371.55	1498.53	1429.28	2163.69	3502.44	5438.66	6025.75	6047.07
Non-tax revenue	402.41	327.38	284.38	203.40	122.26	235.06	269.53	472.84	753.53	165.10	606.95	791.29
Grants	121.69	2.32	0.00	45.00	22.17	19.64	9.66	110.91	178.20	341.57	381.32	555.43
GDP	44831	48691	42375	42853	33499	32647	31188	32831	36769	45158.00	47120	50859
CPI	24.9	43.1	66.6	100.0	2216.5	264.8	590.0	824.1	909.1	1132.4	1583.2	2080.0
Total revenue	4581.93	3229.93	3903.90	2949.90	1493.81	1733.57	1725.81	2636.54	4255.97	5603.76	6632.71	6838.37

Tax rates on imports declined during the period. The total tax rate on imports declined from 55.48% in 1966, to 47.29 in the second half of 1967. The decline continued to 36% in 1968, 32% in 1969 and rose slightly to 37.73% in 1970. The rate of taxation on exports also declined during the period.

Receipts from exports expanded significantly during the period 1967 to 1971. The increase in export earnings was due to both an increase in export volumes and world market price of cocoa. This contributed to the substantial increases in receipts for export duties. In 1971, however, there was a 21.1% drop in export receipts. Import values also increased throughout the period. However, the reduction in taxation was higher than the increase in import values, resulting in a decline in receipts from import duties in 1967 and 1968. As a result, import surcharges were introduced in 1969. But this could not reverse the situation. In 1970 a special development levy was imposed on imports followed by a service payments allocation tax in 1971. Revenues from taxes on domestic goods and services and on income and property also increased as GDP increased in real terms from 1968 to 1970.

The period 1971-82 marked the collapse of liberalization and the re-introduction and maintenance of strict controls. In 1971 real government revenues declined by 6%. With falling cocoa prices and pressure on imports, the government was forced to devalue the currency in December 1971. The new government revalued the currency in January but with a net devaluation of 28%. In spite of the devaluation and controls, real government tax revenue and total revenues declined in 1971, 1972 and 1973. Revenue from domestic taxes on production and expenditure as well as taxes on income and property increased. The decrease in government revenues was therefore due to the decline in revenues from taxes on international transactions, and this was in spite of the increase in general tax rates.

Import volumes decreased as a result of the re-imposition of controls. Growth in exports slowed down. The structure of imports favouring producer goods and fuels and lubricants with lower levels of taxation was maintained, consistent with the import-substituting strategy. As a result, both the cocoa and import tax bases were eroded. The erosion of the tax base is evident in the decline in real GDP figures which began in 1975, three years after the controls were introduced, the decline in export volume and the increasing incidence of smuggling.

In 1974 and 1975, as a result of a substantial increase in the world market price of cocoa, tax revenues from export duties increased by 56% and 15% respectively. Tax revenues from imports increased by 26% in 1974 and declined slightly by 2% in 1975. As a result, tax revenues on international transactions increased by 43%

in 1974 and a further 15% in 1975, resulting in an overall increase in tax revenues of 21% in 1974. In 1975, in spite of the increase in taxes on international transactions, tax revenue on all other sectors decreased by 4%. This was as a result of a 28% decrease in non-tax revenues and an 85% decrease in budgetary grants from abroad. The year 1975 was a critical one in the economy of Ghana. While GDP increased at a modest rate throughout the period 1971 to 1974, in 1975 real GDP decreased by 13%. From 1976, real government tax revenue and other revenues declined throughout the period to 1982. This was due to the shrinking tax base and controlled regime. The tax base on cocoa and imports declined throughout the period. The cocoa tax base declined continuously from 10.6% in 1974 to 2.5% in 1982. The imports tax base declined from 19.5% in 1974 to 6.8% in 1982.[6]

The decline in the tax base was in part due to declining cocoa export volumes and imports, consequent upon the government's policies. It was in part also due to the increased shift of economic activities from formal channels to the parallel market. With a highly overvalued exchange rate and a general shortage of all commodities in the system, cocoa smuggling across the border, both for higher prices and the purchase of basic commodities, increased. Middlemen imported commodities through unofficial channels and priced them at parallel market rates (or what Ghanaians called "the World Bank rate" or "IBM rate") without paying taxes.

While government revenues were declining throughout this period, expenditures were increasing. For this period government spending had no relation to budgetary plans. A political lesson that has been learnt by most political aspirants in Ghana dating back to the colonial days was that political success depended on the ability to minimize the discontent of the urban classes. Therefore, from 1975, as the rate of inflation accelerated and the controlled system failed to supply commodities, either in sufficient quantities or at controlled prices, urban unrest developed. To placate these groups, government expenditure financed by borrowing from the banking system increased. For the 1976/77 fiscal year, the original estimated deficit on current account was only around C20 million and the year actually ended with a deficit of C233 million. During 1977-78, though a surplus was envisaged originally, the government incurred a huge current account deficit of C1,119 million. Against a large surplus of C287 million envisaged for 1978-79, a deficit of C346 million was incurred during that year.

> Even though the deficits were incurred on account of large increases in expenditures by the government, an overwhelming

> proportion of the increases were on account of recurrent expenditure: development expenditures moved up slowly and far behind the rate of inflation. Thus, investment in the government sector in real terms recorded a declining trend (CBS, 1980, p. 22).

With the introduction of the Economic Recovery Programme in April 1983, both the economy and government revenues responded positively. In 1983 tax revenues declined by 4.6% as a result of the drought and general collapse in the economy. However, from 1984, when GDP started growing in real terms, government tax revenues increased steadily from 1984 to 1988. Revenues from almost all sources increased.With continuous depreciation of the currency and payments of higher prices to cocoa farmers, export volumes increased resulting in higher revenues from export taxes. This was in spite of declining world market prices for cocoa. The London spot price for cocoa declined from 2113/tonne in 1985 to 1146/tonne in 1988 (CBS, *Quarterly Digest*, September 1989). In 1988, however, according to World Bank estimates (World Bank, 1989), cocoa production fell by 6.8%. The combination of decreased cocoa exports and a lower world market price reduced tax revenues for cocoa exports by 31% resulting in a 15.8% fall in revenues from international transactions. This was, however, compensated for by increased earnings for other sectors. With increased export earnings and external donor support, imports increased in real terms throughout the period.

While a major part of the growth in government revenues could be explained by the policy change and the response of the economy to the change, part of the increase could be explained by the broadening of the tax base and increased efficiency in tax collection. A combination of tax farming and re-organization of the tax administration was undertaken. The agency responsible for customs and excise duties was converted into services with a board of directors and conditions of service related to their tax performance. The collection of income taxes from commercial vehicle operations became the responsibility of the Ghana Private Road Transport Union (GPRTU) in return for a percentage of taxes collected. The GPRTU collects these taxes on a daily basis as the drivers report to commence operations for the day and has trained personnel to do on-the-spot checks on drivers for tax receipts for the day.

In spite of the growth in revenues, the fiscal deficit continued to increase. Tax revenue less expenditure which was in deficit of C6.7 billion in 1983 increased throughout the period to C24.1 billion in 1988. However, overall budgetary surpluses were recorded in 1986 through to 1988, largely on account of non-tax revenues. Grants, mainly from abroad in support of the budget, increased from C914 million in 1984 to C11,553 million in 1988, constituting about 7.5% of government revenue in that year. Substantial debt service relief was also obtained by the conversion of loans into grants by the major western countries. The increase in government expenditure therefore occurred largely as a result of domestic activities.

With the massive devaluation of April 1983 and the drastic reduction in real wages, the government resorted to increasing wages, salaries and other benefits as a partial compensation. As a result, the employee compensation component of government expenditure increased from C5.3 billion in 1984 to C49.2 billion in 1988. Purchases of other goods and services increased by a more moderate amount from C10.1 billion in 1984 to C29.2 billion in 1988. Development expenditure increased at a faster rate than recurrent expenditure.

V Foreign capital and liberalization

External capital flows could be crucial to the success or failure of a liberalization attempt. In the case of Korea, for instance, it has been documented that substantial external inflows contributed to the success of the liberalization experience (Helleiner, 1988). The two liberalization episodes in Ghana differed not only in terms of the liberalization package but also in terms of external donor support.

In both periods, the government expected substantial external support when putting together the liberalization package. In the period 1967-69 the yearly average support from DAC member countries in the form of loans and grants amounted to US$75 million of which grants were US$16 million. The period 1970-71 averaged US$82 million of which US$24 million was in the form of grants. These flows of loans and grants were equivalent to 18.3% and 17.5% of total imports for each respective period. These represented an increase in capital inflows compared with the 1966-67 period. The increase is in recognition of the donor community's expectation of a further liberalization episode by the government. But as Leith (1974) argues, these inflows were in danger of being overcome by repayments. Grants were insignificant in terms of budgetary support. In most years during this period it was less than 0.001% of total revenues.

In contrast, the current programme has had substantial external assistance both as programme aid and budgetary support. As discussed earlier, by 1988 external grants constituted 7.5% of government revenue. External programme support was co-ordinated through the Paris Club Donors Conference. According to World Bank (1990) commitments from members and observers of the consultative group including IDA averaged US$420 million a year in 1984-86 and US$740 million a year between 1987-89. Drawings on loans increased from approximately US$272.6 million in 1983 to US$426.8 million in 1988. In the initial phases external resources including suppliers' credit and bilateral arrangements financed 49.1% and 43.7% of total imports in 1983 and 1984 respectively. In 1985 this had declined to 37.1% (Ministry of Trade, 1986). As import liberalization started in

1986, the level of foreign funding increased to 54.3% in order to accommodate the increase in imports.

Ghana's total stock of external debt stood at US$3.2 billion by the end of 1989. This was about 60% of GNP. Long-term public debt amounted to US$2.6 billion, 32% of which was bilateral creditors, 44% from the World Bank and IDA, and 17% from other multilateral sources (Table 27).

External support has gone to the foreign exchange operations. The finances of the foreign exchange auction by foreign sources increased from about 40.6% in 1986 to 69.3% in 1988 (Ministry of Trade, 1988).

The significant inflow of foreign financial resources has financed the current account deficit and built up international reserves. Gross inflows of loans and grants over the period 1983-89 have been crucial in supporting the structural adjustment programme in terms of the budget, balance of payments and financing of the auction. In contrast to the 1967-71 period where these inflows were approximately equal to 18% of merchandise imports, in the current period they are approximately 60%. At the initial phases, however, the programme had to rely on short-term borrowing from the IMF and other commercial sources. At this stage Ghana's creditworthiness was low and it was difficult to attract long-term concessional financing. The share of short-term credit in total external debt increased from 20.1% in 1982 to 26.3% in 1983 and 40.7% by 1985 (Table 27). As the programme progressed and creditworthiness improved, the share of long-term concessional loans in financing the programmed increased. The current import liberalization programme has therefore not been constrained by the performance of the export sector. The inflows have allowed the programme to continue despite adverse developments in the international cocoa market. This contrasts with the abrupt end to the liberalization programme in 1971 when cocoa prices declined. The external support for the current programme has been more far-reaching than it was in the previous liberalization phase.

Foreign direct investment played a more significant role in the earlier liberalization period than in the current programme. Even though it fluctuated from year to year, for the period 1967-71 foreign direct investment averaged US$31.4 million per year, whilst it averaged only US$5.6 million between 1983-89.

The current liberalization programme has also encouraged the inflow of private transfers by Ghanaians resident abroad. In 1983 these transfers were approximately US$4.02 million. They more than tripled to US$15.9 million in the following year and by 1987 had risen to US$122.4 million (IMF, 1990).

Table 27 Ghana's external debt burden, 1980-1989

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Total debt stocks (TDS)	1314	1416	1397	1598	1898	2174	2652	3134	3113	3078
Use of IMF credit	105	28	75	331	515	701	786	867	762	787
Short-term debt	131	276	206	90	238	183	173	180	108	67
Total short-term (TST)	236	304	281	421	753	884	969	1047	870	804
Interest (%)	1.7	2.6	5.9	2.2	1.9	4.2	4.7	3.1	1.0	2.8
Maturity (years)	43.7	29.6	18.1	36.5	39.1	30.3	25.6	33.0	32.3	38.1
Grace period (years)	9.7	7.3	4.3	7.7	8.5	7.2	6.2	8.5	7.9	8.9
Grant element (%)	71.9	55.6	26.7	63.7	69.8	46.9	39.0	55.8	70.9	60.2
Debt service ratios(%)										
a) excluding IMF						46.7	38.5	28.9	31.1	28.2
b) including IMF						53.3	48.7	53.9	63.3	58.4
TST/TDS	18.0	21.5	20.1	26.3	39.7	40.7	36.5	33.4	27.9	26.1

Source: World Bank, 1990b, 1991.

It would seem from the Ghanaian experience, therefore, that substantial external assistance over a certain period may be essential for the success and continuation of a liberalization programme. In both liberalization phases imports rose significantly in response to liberalization attempts. This has been due to the release of pent-up demand and the necessity of supplying imported inputs to the import-strangulated tradable goods sector. In an economy highly dependent on imported inputs, the growth objective of the import liberalization programme may not be achieved without these inflows since the ability of the relevant sectors to respond will be constrained by the non-availability of required imported inputs. However, the subsequent debt burden when most of these inflows are loans could have adverse implications for future balance of payments positions. A second limitation of the usefulness of foreign inflows relates to the absorptive capacity of the economy and the possible build-up of reserves and appreciation of the currency. There may be a significant relationship between external inflows, the exchange rate and inflation. This has been a concern expressed in Ghana.

VI The trade and payments regime and inflation

Inflation can be analyzed in terms of monetarist or cost-push views. Monetarists argue that cost-push factors such as food prices, wage or exchange rate changes can only cause a shift in the price level but cannot lead to sustained inflation. For this to happen, there is a need for monetary accommodation, without which the inflationary process stalls. Chhibber and Shafik (1990) argue that while money can be viewed as the proximate cause of inflation, cost-push factors can drive directly or indirectly by bringing about changes in the rate of monetization and velocity of circulation of money. This process works through the impact of exchange rate and wage changes, as well as changes in other administered prices which affect the fiscal deficit. When the deficit gets monetized, inflation results. This process has been found to be important in Ghana.

Monetary and cost-push factors can finally result in excess demand which could be inflationary. As argued in Leith (1974), a country's trade and payments systems affect the nature of adjustment between aggregate demand and aggregate supply. A response to increased expenditure on aggregate supply must involve some adjustment via increases in imports and in the price of domestic output or a reduction in the value of expenditure components. If the system permits a free flow of trade and payments without quantitative restrictions, then for a small country, the domestic price level of tradables is linked directly with international prices of the same goods. Under these circumstances, aggregate demand pressure is vented largely on external balance with increased imports and decreased exports; the domestic price level of tradables is given by international prices. If adjustment via the external balance is blocked by controls on imports, the link with international prices is cut. Aggregate demand pressure is then turned onto the domestic price level to achieve adjustment, leaving unsatisfied excess demand for imports.

The level of excess demand of a country at the point of liberalization is important in explaining the inflationary situation. The inflationary situation will be worsened if excess demand exists at the time of liberalization. Excess demand in Ghana was generated using a simulation approach. Following

Chhibber and Shafik (1990) excess demand in the goods market is assumed to be equivalent to excess supply in the money market. This assumption is based on Walras's law and is supported by the fact that in Ghana the substitution between money and goods is far more important than that between money and other financial assets. The excess supply of money was specified as the log difference of real money supply to real money demand. A demand function as estimated by Sowa (1989) is used to simulate the excess supply with its equivalent to excess demand (see Table 30).

Regimes and impact on inflation

The rate of inflation was generally under 7% until 1964 when it hit 16% (Table 28). Before 1959, the balance between aggregate demand and aggregate supply was maintained. However, in 1959, as a result of the desire to speed up development, the government incurred a substantial deficit, creating an excess of total expenditure over output. With a fixed exchange rate and a fairly liberalized international trade and payments regime, the adjustment resulted in increased imports of goods and services (Sowa, 1989, p.38). The value of total imports shot up by 34% from NC169 million in 1958 to NC226 million in 1959. This demand was met via a current account deficit which was financed by drawing on foreign exchange reserves and external capital account borrowing, largely on the part of government. The pressure on aggregate demand was, therefore, largely unleashed on the external balance and not on domestic prices.

The rate of inflation became a problem from 1964. The period 1961-63 had an average inflation rate of 6% a year. Although the controlled regime had been initiated in 1961 as a result of balance of payments problems, the rate of inflation for this period was low because there were sufficient imports to contain aggregate demand. This is supported partly by the fact that reserves dropped from NC297 million to NC147 million in 1961 (Leith, 1974, p. 38). Besides, excess demand had just begun to develop (Table 30). Table 29 shows that 1963 recorded no growth in money supply indicating it was also under control.

The inflationary situation became serious between 1964-66, averaging about 18% a year. The period recorded severe shortages of basic consumer goods. The world price of cocoa fell to its lowest level ever in 1965, contributing to a precarious foreign exchange position. Excess demand increased steeply from C454.3 million in 1963 to C4,098.5 million in 1964 before dropping to C1,409.3 million in 1967 (Table 30). In an effort to absorb the excess demand spilling over into imports, higher taxes on imports were imposed during this period. This resulted in an increase in the effective exchange rate for imports by almost 33% in 1966 compared with 1960. This was not enough to keep relative prices of imports in line with the domestic price level. This was reflected in the rate of inflation increasing from 16% in 1964 to 23% in 1965 before declining to 6% in 1969.

Table 28 Rate of inflation, 1961-90

Year	Rate	Year	Rate
1961	6	1976	55
1962	6	1977	116
1963	5	1978	73
1964	16	1979	55
1965	23	1980	50
1966	15	1981	116
1967	10	1982	22
1968	11	1983	123
1969	6	1984	40
1970	3	1985	10
1971	9	1986	24
1972	11	1987	40
1973	17	1988	31
1974	19	1989	25
1975	30	1990	37

Source: rate calculated from CPI, CBS, *Quarterly Digest*, 1980, 1989; CBS, *Economic Survey*, 1969

Budget deficits as a proportion of GNP increased from 7.8% in 1965 to 8.9% in 1966 before declining (Table 30). Part of the deficit seemed to have been monetized. From a zero growth in the money supply in 1963, there was a steep increase in M2 of 32% (Table 29). The rate of money supply also reached the highest level of 23.9% in the 1960-66 period in 1964. Thus, monetization of deficits and high excess demand contributed to the high rate of inflation over the 1964-66 period.

Table 29 Change in money supply 1963-75 (%)

Year	M1	M2	Year	M1	M2
1963	0	0	1976	42	37
1964	41	32	1977	67	60
1966	8	7	1978	73	69
1967	-4	0	1979	13	16
1968	8	9	1980	30	34
1969	11	11	1981	55	51
1970	7	10	1982	19	23
1971	3	9	1983	49	40
1972	-	43	1984	61	54
1973	-	18	1985	43	46
1974	25	28	1986	44	48
1975	44	38			

Source: calculated from money supply figures, CBS, *Economic Survey,* 1969; CBS, *Quarterly Digest*, 1980, 1988.

The import liberalization period 1967-71 marks a phase corresponding to a low rate of inflation. The lowest inflation rate since 1961 was 3% in 1970. The rate of inflation was declining from the 1965 high of 23% when the import liberalization was attempted in 1967. Excess demand declined over the 1964-66 period to the lowest level in 1966 before liberalization was initiated. Although excess demand began to grow progressively from 1967, aggregate demand seemed to have been contained. The comparatively low deficit rates which averaged 5.3% combined with low money growth rates and increased imports explain the containment of aggregate demand. These reasons account for the low inflation rate over the period.

The inflation rate which began to rise in 1971 continued throughout the period 1972-82. This period can be described as the most inflationary in Ghana's recent economic history. From a rate of 30% in 1975, inflation peaked at 116% in 1977 and closed the decade at 54%. This controlled period saw a noticeable fall in total import volumes compared with other periods.

Table 30 Some key financial indicators 1966-88 (%)

Year	Excess demand (m. cedis)	M2/GDP	Deficit/GNP
1960	-	18.4	-
1961	-910.6	18.7	-
1962	381.0	20.1	-
1963	454.3	19.5	-
1964	4098.5	23.9	-
1965	3147.7	20.5	7.8
1966	1409.3	20.2	8.9
1967	2631.7	21.2	5.4
1968	3520.4	20.7	7.8
1969	3861.2	19.5	4.0
1970	4203.3	18.9	3.4
1971	1890.1	20.0	5.8
1972	6164.6	23.7	5.5
1973	8712.9	22.7	4.5
1974	10366.4	21.6	7.7
1975	12042.1	26.3	11.9
1976	12695.4	29.2	13.4
1977	10746.8	27.3	13.3
1978	10612.8	24.5	9.1
1979	8156.2	21.1	5.9
1980	7473.3	18.5	10.4
1981	5310.7	16.6	5.9
1982	5497.5	17.2	6.0
1983	3463.8	11.3	2.5
1984	3830.6	11.8	1.5
1985	5089.3	14.0	1.6
1986	6046.3	13.5	0.6*
1987	6642.1	14.2	1.2*
1988	7405.2	14.7	-

Note: * surplus

Source: calculated from IMF *International Financial Statistics Yearbook*, 1988, 1989 and 1990.

The 1975-79 period recorded one of the highest budget deficits. The deficit rate peaked at 13.4% in 1976 before falling to 6% in 1982. The M2/GDP ratio which peaked at 29% in 1976 recorded an average of 22.6% which is the highest for the 1950-90 period. The increase in money supply as depicted by changes in M2 was also the highest (Table 29). It appears, therefore, that the deficits were financed through an increase in the money supply. Thus while the money supply was increasing, translating into an increased aggregate demand, import volumes were declining. Excess demand over the period increased to the highest level in 1976 before dropping. With insufficient availability of consumables, due to shortages of local food items, Sahelian drought and bushfires of 1981-83, aggregate demand was vented on domestic prices. Thus this period's inflation exhibits a monetization of deficits which generated an increased excess demand as a result of shortages of supplies.

Comparing this regime with the first controlled regime of 1961-66, the first one recorded comparatively low rates of inflation. The earlier years, i.e., 1961-64 and 1972-75, coincided with the availability of consumables while the latter periods experienced scarcities. While the deficits of the second period were monetized, the government relied on accumulated reserves during the 1961-66 period.

The economy which had been contracting since 1981 hit its lowest level in 1983. Severe shortages of local food items coupled with a high growth rate of the money supply resulted in the highest inflation rate of 123% in 1983. From that level, the rate of inflation dropped to 40% in 1984 with a further decline to 10% in 1985. Despite conscious policies under the adjustment programme such as credit squeeze and restraining of government expenditure, the rate of inflation resumed its upward trend. Between 1986 and 1990, inflation averaged about 32%. The drop in the inflation rate in 1984 and 1985 could be explained by the exceptionally good weather and bumper harvest of staples. It should also be noted that by 1983, most items on the market were priced at the parallel market exchange rate so that the subsequent devaluations of the currency were just catching up with the already high parallel prices.

This liberalization period (1983-90) has a higher average inflation rate than 1967-71. This could partly be explained by the fact that the current period began with a higher excess demand and partly by a wider divergence between the parallel and official exchange rates. One other possible reason could be the increased cost of production as a results of the continuous depreciation of the cedi during the current period.

In general, periods of liberalization coincided with lower inflation than controlled periods. This is despite the theoretical possibility that liberalization with floating exchange rates could be inflationary. The control period of 1961-66 did not suffer from serious inflation because of the reliance on external reserves and availability of goods and services. The control period of 1972-82 experienced the highest budget deficits and monetary expansion compared with the other periods. Furthermore, shortage of consumer goods and services was more predominant during this controlled period. It could be noted that the rate of inflation in the current liberalization period has remained below the 1972-82 period partly because of increased inflow of foreign resources which have improved both the budget situation and import supplies.

VII Summary and conclusion

The effects of changes on the trade and payments regime of the trade balance cannot be determined *a priori*. The evidence from Ghana suggests that liberalization with a real depreciation of the exchange rate is more likely to lead to improved export performance. In all cases, the liberalization led to an increase in import volumes and real import values. But whether it improves the trade balance or not will depend on the terms of trade and the accompanying macroeconomic constraints on imports.

The change in the composition of imports deliberately effected in 1961 through the use of an import licensing system has not changed. In the short run liberalization has not had any significant effect on the composition of imports because of the structure and nature of industry in Ghana. It is possible that in the long run, as the liberalization process continues, significant changes in relative prices and changes in the structure of industry could induce a change in the composition of imports.

The level of external support is important in determining the sustainability of a trade and payments liberalization programme. This is evident from the divergent experiences of the two liberalization exercises. This is especially so when the terms of trade are unfavourable. A conducive macroeconomic climate may not be sufficient to attract adequate foreign direct investment.

There is a tendency for higher budget deficits to occur during controlled regimes compared with liberalized regimes. This has not been simply a question of the differences in fiscal restraint, but because revenues have generally increased during liberalized periods.

During periods of controls it was found that budget deficits were generally monetized, in contrast to the liberalized period. Following from this, and also from the inability of excess demand to be satisfied through imports, controlled periods are associated with higher rates of inflation.

The Ghanaian experience also provides lessons for the sequencing of trade reforms. The liberalization episodes were preceded by stabilization and exchange rate adjustments. The gains made during stabilization should be maintained in subsequent years.

All the important ingredients for a sustainable liberalization package seem to have been met in the current Ghanaian exercise. The sustainability of this programme, however, has depended critically on external support which, if suddenly curtailed, can bring the programme to an abrupt halt. Since the availability of external financial resources is the one element of the package which is beyond the control of domestic policy, it is essential that the liberalization programme provides the basis for sustainable growth of the Ghanaian economy. If this does not happen, the external inflows will be the Achilles heel of the programme because of the implications for meeting future debt obligations resulting from current external inflows.

An emerging issue of concern for policy analysis is the relationship between external inflows, absorptive capacity of the economy, reserve accumulation on the one hand and the exchange rate and increasing inflation on the other. These have implications for export incentives and the balance of payments.

Notes

1. 1979 was an exception because of the political developments during this year. It was the year of the Armed Forces Revolutionary Council and a change to a new civilian regime in September.

2. A weakness of these studies is the lack of consistent criteria to indentify and therefore compare liberalization episodes across countries (Greenaway, 1993).

3. In discussing balance of payments, two caveats with respect to data are necessary. Substantially different conclusions can be arrived at by analyses of the same period on the valuation of exports and imports. In most World Bank publications, imports are recorded CIF whilst exports are FOB. IMF publications report both FOB. For uniformity of valuation both exports and imports are reported FOB for this analysis.

4. This section is based on comments by an anonymous referee.

5. Estimates of the ratio of consumer goods imports to total domestic consumption have not found any significant difference in these ratios between the different trade regimes. The average for the period 1967-71 was 5.84 %, it declined to 2.77% during the control period 1972-82. It was approximately 1.65% in 1983 and 1984. However, it has increased since then to 4.16% in 1987, declining to 3.35% in 1988.

6. For a discussion of different measures of fiscal deficit and its application to Ghana, see Islam and Wetzel (1991). For a discussion of the limitations of the conventional measure in an inflationary situation, see Blejer and Chu (1988).

7. Leith, 1974, Tables II-1, and II-2.

8. Frimpong-Ansah: based on three-year moving averages of cocoa, exports, imports and GDP. The tax base is the ratio of the relevant sector to GDP.

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AFRICAN ECONOMIC RESEARCH CONSORTIUM

P.O. BOX 62882
NAIROBI, KENYA

TELEPHONE (254-2) 228057
225234 215898 212359
332438 225087

TELEX 22480

FAX (254-2) 219308

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